

OXFORD

FOURTH EDITION

STRATEGIC MANAGEMENT

Towards sustainable strategies
in southern Africa

LOUW & VENTER (Editors)

Amos Davis Hamann

Jansen van Rensburg Callaghan

Neuland Perks Venter

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Preface

The fact that we are working on the preface for a fourth edition of *Strategic Management* suggests that a southern African textbook on strategic management was indeed well received by its target market. In this edition we continue with the theme of developing strategies that contribute to organisational sustainability, placing it well and truly in the southern African context. The number of public and private sector governance failures that we have faced over the past few years suggests that the need for organisations to manage their own resources while at the same time being responsible, sustainable, and global corporate citizens is as acute as ever. *Strategic Management 4e* is aimed at the future business and public sector leaders in southern Africa, namely the senior undergraduate and postgraduate students in business, and specifically in strategic management.

As calls for Africanisation and decolonisation intensify, we believe that it is important to balance the African context with relevant global insights to enable African leaders and organisations to play their rightful role in the region, but also in the global economy. Therefore, as in previous editions, the general structure of the book and the strategic management principles should be recognisable from global content on strategic management. To this we add a southern African feel with local examples and cases that we use and integrate into the discussion, including four more extensive regional cases to enlighten certain sections of the book. We have also continued our practice of including topics that may not form part of conventional strategic management books, but that we feel are critical to contemporary southern African organisations.

- **Part 1** introduces the nature of strategic management ([Chapter 1](#)), what it means to be a stakeholder-focused sustainable organisation ([Chapter 2](#)), and the importance of strategic direction ([Chapter 3](#)). In this section, [Chapter 2](#) (on sustainable organisations) has undergone a major revision to make it even more suited and practical to southern African organisations.
- **Part 2** focuses on strategic analysis. Strategic management should depend heavily on an in-depth understanding of the risks in the external environment ([Chapters 5 and 6](#)) and the organisation's strategic resources and capabilities ([Chapter 7](#)). While most strategic management books emphasise the importance of external and internal environmental analysis, a few include strategic decision-making. This is an aspect that we now include in [Chapter 4](#), building on our previous focus on the enablers of strategic decision-making.
- **Part 3** addresses the concepts of strategy development and formulation. Strategies can focus on the level of strategic business units: business level strategy ([Chapter 8](#)), corporate level strategy in the multi-business organisation ([Chapter 10](#)), and strategies for global expansion ([Chapter 11](#)). In addition, we have continued with our focus on strategic innovation as an important element for strategic renewal and contextualisation of strategy ([Chapter 9](#)).
- A strategy is ultimately only as successful as its implementation. **Part 4** examines the critical role of strategic leadership in all aspects of strategic management ([Chapter 12](#)), while [Chapter 13](#) deals with strategy implementation as the task of ensuring alignments between strategy and organisational architecture. [Chapter 14](#) was also updated significantly and focuses specifically on the growing field of strategic risk management. It addresses the processes for identifying and responding to strategic risks, and organisational processes for strategic risk management.

As usual, any update of a textbook is the culmination of a lot of hard work by a team of colleagues. Thank you to our team of chapter and case study authors, and to the colleagues at Oxford University Press South Africa, namely the publisher, Janine Loedolff, and her team, Liezl Roux and Nicola van Rhyn.

Lynette Louw & Peet Venter

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PART ONE

**Strategy, stakeholders and
strategic direction**

CHAPTER 1

Introduction: The nature of strategic management

Lynette Louw

LEARNING OUTCOMES

After reading this chapter, you should be able to:

- explain the essence of strategy
- demonstrate an understanding of strategy development and perspectives of strategy
- discuss the nature and role of strategy
- explain the concept of strategic management
- formulate an argument on the different perspectives of managing strategically
- identify and explain the elements of the strategic management process
- identify and explain the tests for a winning strategy
- demonstrate an understanding of strategic paradoxes.

KEY TERMS

business model
competitive advantage
complexity theory
dynamic capabilities
multiple connections
strategic flexibility
strategic frames
sustainability
values

OPENING CASE STUDY



Insight into Shoprite Holdings Ltd's strategy¹

Shoprite Holdings Ltd, headquartered in Brackenfell, South Africa, opened their first small supermarket in 1979 when Pep Stores purchased a small 8-store Western Cape grocer, named Shoprite. In 1980 their vision was set, focusing on the middle-to-lower income market and internal growth with acquisition of promising supermarkets. During the 1980s they expanded nationally and 1990 marks their first expansion across the African continent. In 1991 The Shoprite Group acquired the Checkers chain of supermarkets and increased their footprint fourfold to 241 outlets. In 1997 they acquired OK Bazaars Group from SAB. The Group was added to the JSE Top-40 index of blue chips in 2008.

The Shoprite Group was rated as the biggest South African retailer in the 2019 Deloitte Global Powers of Retail Report based on revenue. It is the only South African retailer to be listed in the top 100 and is placed 86th in the world. The report ranks the 250 biggest retail groups across the world. The Shoprite Holdings Group employs over 146 000 people and has grown to more than 2 738 outlets in 15 countries across Africa and the Indian Ocean Islands.

The Group operates across the following market segments, namely Food, Household products, Furniture, Pharmaceutical and other Services. Other services include financial and ticketing services to consumers through Computicket stores.

Shoprite Holdings Ltd's mission is to 'deliver low prices in a world-class shopping environment to customers across the African continent by bringing choice, quality products and job creation to communities in all the countries' they serve. The company is very committed to living out their values in that they aspire to become a global leader in customer service by putting the customer first. Shoprite Holdings Ltd firmly believe in treating all people, be it their colleagues or customers, with respect and integrity and acting fairly in all dealings.

According to the Chairman of Shoprite Holdings Ltd, their success rests on their ability to maintain their position as a market leader and deliver on their low-cost promise and value proposition across diverse locations in Africa.

The CEO reiterated on numerous occasions that everything that they do is, first and foremost, geared towards improving their service to their customers. Therefore the Group's diversified portfolio enables them to maximise business performance during bad times. Shoprite have implemented six drivers of growth – a customer first culture, growing LSM 8–10 share of wallet, developing a private label, developing a stronger franchise offering, strategic footprint expansion and leveraging their African advantage. They retain a competitive advantage by investing in innovation, staying abreast of international best practice, undertaking preventative measures, continually managing risk and staying true to their core business – providing quality, affordable food in a world-class shopping environment.

Shoprite Holdings Ltd are also following a strategy of expanding internationally. They currently have 308 outlets in 15 other African and Indian Ocean islands and are also planning to further expand into the African continent and Eastern Europe. Their expansion into other countries in Africa began in 1990 with the opening of their first supermarket in Windhoek, Namibia. From 2000 to 2012 they opened stores in countries such as Uganda, Zimbabwe, Egypt, Malawi, Madagascar, Zambia, Nigeria, Democratic Republic of Congo, India and in 2018 in Kenya.

Shoprite's CEO is of the view that their growth strategy has been to purchase businesses in the past, but organic development is now their main growth driver. They have three core supermarket brands each with a distinctive positioning in the market:

- Usave, a discounter with limited choice
- Shoprite, with a low price leadership strategy
- Checkers, catering to more upmarket consumers.

In catering to more upmarket consumers, their corporate strategy, according to their CEO, is not about replicating other upmarket retailers, but to 'dismantle the monopoly of premium food trade'. This new strategy has opened new generation Checkers stores in wealthy areas boasting a wide selection of fresh produce, wine, meat, cheese and many convenience foodstuffs. Shoprite is also working in partnership with international chef Gordon Ramsay to develop a range of convenience and ready-to-eat meals.

A further key growth driver according to the CEO is the addition of complementary business services such as pharmacies, liquor outlets, event ticketing services and basic financial services.

The Shoprite Group's success depends on its ability to consistently provide communities in Africa with food and household items in a First World shopping environment at the lowest possible prices. At the same time, the Group encourages and contributes to the development of stable economies in the countries in which it operates and the social upliftment of its people. For example, the Shoprite Group has partnered with Food & Trees for Africa, where they work with community garden projects to help upskill the community and increase production capacity in order to enhance food security in local communities and also to assist them in earning a living from their garden projects.

The Shoprite Group has adopted and implemented a sound governance model through the introduction of specialist disciplines such as audit and risk, and legal and compliance management. In 2017 a Social and Ethics Committee was established, charged with ensuring that Shoprite business is conducted holistically and operates in a responsible, ethical and sustainable manner. Their corporate social investment program supports the communities that they operate within by fighting hunger, empowering women, developing skills and demonstrating that they #ActForChange.

According to the Shoprite Holdings Ltd sustainability report for 2017, the organisation highlights the importance of the support they receive from their capitals and are of the opinion that their continued success rests on effective engagement with their customers, communities, employees and suppliers, and access to a healthy and stable natural capital base. The six capital bases include human, social and relationship, natural, intellectual, manufactured and financial capitals.

Overview

The purpose of this chapter is twofold – firstly, to introduce the nature of strategic management as relevant to the focus of this text, and secondly, to provide a guide to the structure and content of this text by means of the strategic management framework.

[Section 1.2](#) introduces the nature of strategic management and provides an overview of the essence of strategy, including a description of the concept of strategy and an explanation of how historical context has influenced the development of strategy. [Section 1.3](#) explains the nature and role of strategy in terms of the five Ps of strategy and the levels of strategy, culminating in a definition of strategic management in [section 1.4](#). [Section 1.5](#) discusses two different perspectives on managing strategically. This text uses perspectives on managing strategically to understand the nature of strategic management in the contemporary dynamic competitive landscape, which requires an organisation to be strategically flexible in order to attain a **competitive advantage**. **Strategic flexibility** requires an organisation to have the dynamic capabilities necessary to deal with uncertainty and risk in responding to the demands and opportunities in uncertain competitive environments.² An organisation can attain a competitive advantage by making optimal use of its resources (resource-based and dynamic capabilities viewpoint, i.e. the inside-out perspective), and combining them with its external environment (i.e. the outside-in perspective). In the context of this text, an organisation can achieve a competitive advantage with above-average returns by creating superior value, managing ethically, and being sustainable. A competitive advantage can be achieved by an organisation when superior value is created for its customers compared with its competitors or when it outperforms its competitors in key areas, such as profitability. A competitive advantage can only be sustainable if an organisation persists in creating superior value compared with its competitors.³ Sustainability and strategy are thus considered to be inseparable.

[Section 1.6](#) discusses the strategic management process, illustrated in the strategic management framework in [Figure 1.6](#), in terms of **stakeholders** and strategic direction, strategic analysis, strategy development and formulation, and **strategy alignment and implementation**.

The discussion on the strategic management process continues with understanding the purpose and context of a sustainable organisation ([Chapter 2](#)) and the setting of the strategic direction for an organisation ([Chapter 3](#)). This is done within the context of understanding what it means to be a sustainable organisation that is stakeholder-focused (discussed in [Chapter 2](#)). The concept of **sustainability** relates to the maintenance and enhancement of environmental, social and economic resources to meet the needs of current and future generations. It also implies

that organisations should integrate corporate social responsibility, stakeholder claims, corporate citizenship and social entrepreneurship into their strategic planning and implementation.

Chapters 4 to 7 deal with strategic analysis. This consists of the strategic decision-making process and its influences, and the strategic link between the organisation's external environment and the opportunities and threats it presents (outside-in perspective), as well as its internal strengths and weaknesses (inside-out perspective). An organisation needs to develop and formulate its strategy based on its strategic direction and analysis. This stage in the strategic management process includes an understanding of the underlying strategic value innovation options (Chapter 9) to develop and formulate strategies at the business level (Chapter 8), corporate level (Chapter 10) and international level (Chapter 11). Once the organisation has developed and formulated its strategies the next step is to implement them. Successful strategy implementation is dependent on strategic leadership, the key driver of implementation (Chapter 12), and organisational alignment through organisational architecture (Chapter 13), supported by strategic risk management (Chapter 14).

The final part of this chapter comprises sections 1.7 and 1.8, which give a brief overview on the tests for a winning strategy and the various strategic paradoxes, which are as follows:

- The past and future
 - Intended and emergent strategy
 - Reactive or proactive approaches to strategy
 - Inside-out or outside-in driven strategies
 - Profitability versus sustainability.
-

1.1 Introduction

Managing an organisation in the competitive landscape of the 21st century is a highly complex task, and has an impact on organisational leadership, strategies and organisational architecture. Among the reasons for the heightened complexity are increasingly competitive business practices, the inclination towards strategic flexibility to accommodate change, the emergence of networked organisations, and the concern for sustainability and business ethics in the global arena. It is vital that leaders think strategically about how they achieve a competitive advantage that is sustainable for the organisation. Leaders need to understand where they fit in the global competitive landscape, what it means to be a sustainable global organisation, and how they can contribute towards strategic development, change and transformation.

In the context of developing countries, especially in Africa, this contribution towards strategic sustainable development and transformation includes, among other things, empowering people from the designated group and involving them in the formal economy, being a responsible corporate citizen, and thinking globally while acting locally, as illustrated by the Shoprite Group in the Opening case study. Consider, for example, how organisations from various economic sectors in South Africa have had to learn how to conduct business and understand the competitive landscape in the rest of Africa and, in most instances, have contributed towards transformation and sustainable development. These examples include South African parastatals (Portnet); the telecommunications sector (MTN, Vodacom); retail, beverage and food sectors (Shoprite, Pick n Pay, Woolworths, Clicks, Unilever); the insurance sector (Old Mutual, Sanlam); and the construction and oil sector (Murray & Roberts, WBHO, Sasol).

When thinking strategically about their organisation's current situation and future prospects in a competitive landscape, management is faced with four critical questions:⁴

- Where are we now?
- Where do we want to go?
- How will we get there?
- How are we doing?

To answer the first question, 'Where are we now?', management should consider:

- the organisation's competitive positioning
- the organisation's resources and dynamic capabilities
- the appeal and innovative value added to its products and services
- the extent to which it meets the needs and expectations of its customers and stakeholders
- the organisation's environmental integrity
- the organisation's current performance.

In the Opening case study, Shoprite Holdings Ltd has successfully managed to integrate its concern for its stakeholders, the environment, economic progress and technological innovation into its strategic management process.

The second question, 'Where do we want to go?' refers to the strategic direction that management believes the organisation should adopt. For example, Shoprite's mission is to 'deliver low prices in a world-class shopping environment to customers across the African continent by bringing choice, quality products and job creation to communities in all the countries' they serve.

The answer to the third question, 'How will we get there?' depends on:

- how strategy is formulated at the different organisational levels based on customer needs, stakeholder expectations, integration with the environment, and ethical perspectives
- the influence of leadership, values, organisational culture and organisational architecture on strategy implementation.

Finally, to answer the last question, 'How are we doing?' requires that strategic leaders manage the performance of the organisation by means of strategic control and risk measures and appropriate feedback.

We propose that in future the extent to which an organisation successfully implements its strategies will be determined by the approach to sustainability it adopts. To refer to sustainable strategic management, there is a growing need for organisations to manage their own **resources** while at the same time being responsible and sustainable global corporate citizens. Both the ecological and social aspects need to be integrated into the strategic vision, analysis, planning and generation of options, and premise the applicability of strategies.⁵ Interestingly, there is a positive association between economic and environmental performance, while corporate social responsibility is closely linked to economic performance.⁶ In the Opening case study on Shoprite Holdings Ltd, it is evident that the organisation began the journey in this direction, moving beyond simply reporting on their triple bottom line (economic, social and environmental) achievement, to including sustainability issues into their strategy development and implementation in pursuit of their **organisational purpose**.

Shoprite produces an integrated report in line with the King IV requirements in South Africa. In their sustainability report for 2017, the organisation highlights the importance of the support they receive from their capitals (human, social and relationship, natural, intellectual, manufactured and financial) and are of the opinion that their continued success rests on effective engagement with their customers, communities, employees and suppliers, and access to a healthy and stable natural capital base. For example, for their natural capital Shoprite is committed to reducing carbon emissions by setting a carbon emission intensity target to reduce metric tonnes of CO₂e per square metre by 25% by 2025 with a base year of 2016.

It is important to note that all organisations require strategies to achieve their purpose, whether they are in developed or developing countries, large or small, profit seeking or not-for-profit, private or public sector. As explained previously, sustaining a competitive advantage is influenced by the organisation's engagement with government, environmental focus (process improvement and products/services), and socio-economic development. Many organisations are realising that the opportunities represented by the large emerging markets demand an entirely new way of thinking in terms of sustainability. The overarching imperative to support developing nations in their quest for better livelihoods, human rights and environmental integrity – in short, sustainable development – is

a challenge, and the business community, ranging from small organisations to multinational corporations, has an important role to play⁷

As managers gain a better understanding of the markets in developing countries, they have to continually rethink and reconfigure every element of their business models.⁸ A **business model** is a plan of how an organisation creates value for its customers while simultaneously generating sufficient revenue or surpluses to have above-average returns. As illustrated in the Opening case study, Shoprite’s involvement in the community partly informs their business model. As the leading retailer in Africa, Shoprite regards themselves as being part of a larger community and represent themselves as socially active, through their dictum of #ActForChange. Whether it be through job creation, ensuring the most affordable products available, lending a hand to those in need or feeding the most vulnerable in our society, they ensure that their business model remains relevant and trustworthy to the communities they serve.

1.2 The essence of strategy

This section presents an overview of the conceptualisation of strategy and the historical perspectives of strategy development.

1.2.1 Strategy conceptualised

The concept of strategy dates back to ancient Athens and the documentation of Sun Tzu’s *The art of war*, written in about 500 BC. Strategy has always been considered to be a key element of managerial activity and is still offered as a capstone course (strategic management) at business schools. But what does strategy really mean? [Table 1.1](#) offers selected definitions to illustrate the complexity of the concept.

Strategy can be regarded as a game plan indicating the collective effort organisations need to make in order to, for example:⁹

- attract customers and meet customer needs
- compete differently from rivals
- create value for customers
- develop the necessary dynamic capabilities
- grow the organisation
- manage the organisational architecture
- achieve performance targets by implementing strategy successfully.

Table 1.1 Selected definitions of strategy¹⁰

Strategy: a plan, method or series of actions designed to achieve a specific goal or effort.	<i>Wordsmyth dictionary</i>
The determination of the long-run goals and objectives of an enterprise and the adoption of courses of action and the allocation of resources necessary for carrying out these goals.	<i>Alfred Chandler, Strategy and structure</i>
A strategy is the pattern or plan that integrates an organisation’s major goals, policies and action sequences into a cohesive whole. A well-formulated strategy helps marshal and allocate an organisation’s resources into a unique and viable posture based upon its relative internal competencies and shortcomings, anticipated changes in the environment, and contingent moves by intelligent opponents.	<i>James Brian Quinn, Strategies for change: logical incrementalism</i>
What business strategy is all about is, in a word, competitive advantage ... The sole purpose of strategic planning	

is to enable a company to gain, as efficiently as possible, a sustainable edge over its competitors. Corporate strategy thus implies an attempt to alter a company's strength relative to that of its competitors in the most efficient way.

Kenichi Ohmae, The mind of the strategist

Without a strategy the organisation is like a ship without a rudder, going around in circles.

Joel Ross and Michael Kami, business authors and consultants

Strategy is about making choices, trade-offs; it's about deliberately choosing to be different.

Michael Porter, professor and consultant

Strategy can also be viewed as 'the direction and scope of an organisation over the long term, which achieves advantage for the organisation through its configuration of resources within a changing environment and to fulfil stakeholder expectations'.¹¹

The next section provides a more comprehensive understanding of this concept by considering its historical origins, context and perspectives.

1.2.2 The historical origins of the concept of strategy

Despite the numerous attempts to define the concept of **strategy** over the decades (see [Table 1.1](#)), efforts are constantly being made to redefine it.¹² A less arbitrary approach to explaining it would be to consider the changing concepts of strategy, as envisioned by academics, managers and consultants.

The concept of strategy derives from the Greek word *strategos* meaning 'a general'. *Strategos* in turn derives from *stratos* (the army) and *agein* (to lead),¹³ so originally strategy was associated with the military – the 'art of leading the army'.¹⁴ Sun Tzu's primal work, *The art of war*, is regarded as the first formal article on strategy. However, it was only in the 20th century that the concept of strategy gained importance in the business world.¹⁵ Military and business operations share some common concepts and principles, particularly strategy and tactics. A tactic is a plan for a specific action, while strategy is the overall scheme for leveraging resources to obtain a competitive advantage.

Strategic decisions, whether in the military or business sphere, share common characteristics:¹⁶

- Strategy is concerned with long-term direction and sustainable success.
- Strategy exploits the links between the internal and external environments – the so-called strategic link.
- Strategies require major resources.
- Strategies are likely to affect the whole organisation.
- Strategies are shaped by the values and expectations of stakeholders.
- Strategies are directed by vision – the ability to move forward.

The next section presents a brief historical overview, and explains the changing concepts of strategy as envisioned by academics, managers and consultants in the 20th century.

1.2.3 Strategy development in the 20th and 21st centuries

During the early 20th century, managers, rather than academics, began to explore and define the management task. Examples include industry leaders such as F.W. Taylor in the USA, who used time and motion studies to identify the best way for employees to perform a task, and Henri Fayol in France, who emphasised formal structures and processes for the adequate performance of all important tasks. Other important contributors include Henry Ford (1908–1915) and Alfred Sloan from General Motors (1920–1935). Henry Ford focused on innovative technology,

mechanisation, quality standards, redesign and cost cutting, while Alfred Sloan emphasised rapid model changes, niche marketing, structured management teams, and separate operational and strategic planning.¹⁷

In 1954, Peter Drucker¹⁸ argued for proactive planning (i.e. planning well in advance) to shape the organisation's environment. In 1957, Philip Zelznick¹⁹ introduced the notion of distinctive competence that became the core concept of the resource-based organisational perspective, as discussed in [section 1.5](#) in this chapter. A distinctive competence refers to a set of activities that an organisation does particularly well, relative to its competitors.

In 1912, the Harvard Business School introduced a capstone course in business policy. To this day, strategy is positioned as a cornerstone of high-performing organisations, while strategic management is offered as a capstone course in many MBA programmes. Although research in the early 2000s suggested that an organisation's strategy is more important to its performance than industry context,²⁰ the authors of this title argue that in the contemporary dynamic business environment, strategy must be closely aligned with the 'fit' between the internal and external environments to enhance superior returns in a particular industry context. This strategic 'fit' is further explained in [section 1.5](#) of this chapter.

[Table 1.2](#) explains the evolution of strategy development from the 1950s to 2018.²¹

1.2.3.1 Strategy in the 20th century

The general theory of competitive behaviour evolved after Von Neumann and Morgenster's *The theory of games and economic behaviour* was published in 1944.²² From the 1950s to the 1970s, writers such as Ansoff developed corporate strategy concepts.²³ Two environmental factors accelerated the development of strategy during the 1950s and 1960s – the accelerated rate of change, and the greater spread of wealth, especially in Europe.²⁴ Research focused on general management and business policy issues to develop better ways of making decisions and maintaining coordination in increasingly large and complex organisations. During this period, rational planning was preferred to the haphazard workings of the market economy.²⁵ Rational planning contributed towards what became known as the prescriptive and predictive approaches to strategy generation. Well-known researchers during this era include Kenneth Andrews (1971), Alfred Chandler (1962) and Igor Ansoff (1965).²⁶

Table 1.2 The evolution of strategic management

Period	1950s	1960s – early 1970s	Late 1970s – mid-1980s	Late 1980s – 1990s	2000s	2010s
Dominant theme	Budgetary planning and control	Corporate planning	Positioning	Competitive advantage	Strategic and organisational innovation	Competitive advantage that is sustainable
Main issues	Financial control through operational and capital budgeting	Planning growth, especially diversification and portfolio planning	• Selecting industries and markets • Positioning for market leadership	• Focusing strategy around sources of competitive advantage • New business development	Reconciling size with flexibility and responsiveness	• Focusing on value innovation • Sustainability • Stakeholder engagement • Winner-takes-all markets • Multiple connections

Period	1950s	1960s – early 1970s	Late 1970s – mid-1980s	Late 1980s – 1990s	2000s	2010s
Principal concepts and techniques	- Financial budgeting - Investment planning - Project appraisal	- Business forecasting - Corporate planning techniques - Synergy	- Industry analysis - Segmentation - Experience curves - PIMS (Profit Impact of Market Strategies) analysis - SBU (Strategic Business Units) - Portfolio planning	- Resources and capabilities - Shareholder value - Knowledge management - Information technology	- Cooperative strategies - Competing for standards - Complexity and self-organisation - Corporate social responsibility	- Value innovation - Stakeholder engagement - Governance and ethics - Multiple scenarios
Organisational implications	Systems of operational and capital budgeting become key mechanisms of coordination and control	- Rise of corporate planning departments and long-term formal planning - Mergers and acquisitions	- Multidivisional and multinational structures - Greater industry and market selectivity	- Restructuring and re-engineering - Refocusing - Outsourcing - E-business	- Alliances and networks - New models of leadership - Informal structures - Less reliance on <i>direction</i> and more on <i>emergence</i>	- Global strategies - Blue ocean strategies – non-disruptive creation - Integrated sustainability reporting - Brokering and participating in stakeholder relationships - More reliance on distinctive capabilities (<i>process</i>) rather than <i>resources</i> - Strategic action and reaction

During this era, strategy was essentially defined as a process, comprising the following sub-processes:²⁷

- identifying and analysing threats and opportunities
- responding to threats and opportunities by formulating strategic plans
- implementing strategic plans
- designing control systems for implementation processes.

In the 1970s, circumstances changed, largely influenced by major increases in the oil price. Diversification did not deliver the anticipated synergies in the organisational value chain, and Japanese, European and Southeast Asian

organisations brought about increased international competition worldwide.²⁸

In the mid-1980s, organisations and academics focused on the analysis of the external environment, and viewed strategy as a quest for positioning and market leadership. This is referred to as the outside-in perspective discussed in [section 1.5.2](#) of this chapter, and includes organisational positioning, attaining a competitive advantage in a changing environment, and maximising profit potential. During this period, contributions were made by, among others, Porter (1980),²⁹ the Boston Consulting Group and the Strategic Planning Institute (Profit Impact of Market Strategies) project.

In the late 1980s and early 1990s, the focus shifted to the internal organisational environment, and from strategic planning to strategic management. This is the inside-out perspective explained in [section 1.5.1](#). Stimulated by the accelerated rate of technological change and the greater spread of wealth, new demands for strategy development were created. Consequently, the source of profitability and the basis of long-term strategy resulted from developments in the resource-based and dynamic capabilities viewpoints, which are explained in [section 1.5](#) in this chapter.³⁰ These viewpoints argued that any form of sustainable competitive advantage results from an organisation's unique resources and dynamic capabilities. The internal focus emphasised the differences within organisations to achieve a competitive advantage. Organisations moved towards specialisation that resulted in outsourcing and the divestment of non-core business activities. The rapid advancement in technology during the late 1990s led to rethinking business models with a move towards the emergence viewpoint of strategic planning, which is explained in the next section.

1.2.3.2 Strategy into the 21st century

At the beginning of the 21st century, key theoretical developments that influenced the rethinking of contemporary business models included the application of game and complexity theories to business,³¹ and the analysis of the disruptive effect of technology.³² **Complexity theory** is a science of complex interacting systems,³³ and is characterised by non-linearity, unpredictability and aperiodicity.³⁴ The challenge was how to incorporate the unpredictable conditions of non-linearity, uncertainty and ambiguity into an organisation's strategy to ensure the sustained management of innovation and change. As far back as 2001, Ilbury and Sunter advocated the re-emergence of scenario planning as a valuable tool in preparing for possible different futures. To support their viewpoint, it is asserted that both the current and future environments need to be considered in strategising and that scenario planning is useful in determining possible futures.³⁵ Other developments included:

- the diagnosis of the 21st century competitive landscape and the impact of globalisation
- the strategic use of knowledge in organisations
- the application of real options thinking (decisions about expanding or ceasing capital investment projects that pertain to tangible assets)³⁶
- risk management
- **multiple connections** or interconnectedness between markets
- the availability of big data
- the power of the cloud and the internet of things (IoT)
- value innovation, blue ocean strategy and non-disruptive creation
- sustainability, governance and ethics
- the principle of action and reaction to strategising.

Managers and academics had to rethink previous business models during the early 21st century. This rethinking was influenced, among other things, by the 2008–2009 recession. Becoming disillusioned with 'shareholder value capitalism', there is a renewed interest in corporate social responsibility, business ethics and sustainability. Sustainability implies that organisations can achieve a competitive advantage with above-average returns by creating

value, managing ethically, and being sustainable, corporate global citizens with social, environmental and economic integrity.

It is interesting to note that even though there is a renewed interest in including sustainability into contemporary business models, the World Commission on Environment and Development had already introduced a broader discourse on sustainable development during the late 20th century. In 1992, the concept was thrust onto centre stage of the global public policy debate at the UN Conference for Environment and Development or the Earth Summit in Rio de Janeiro. In 2000, the UN Secretary-General, Kofi Annan, established the UN Global Compact which indicated how business should become part of the solution to sustainable development while the Global Reporting Initiative (GRI), a multi-stakeholder initiative, developed a set of principles and indicators for sustainability reporting. This was taken one step further by the King Report IV on Corporate Governance, published in 2016, further emphasising the need for integrated sustainability reporting, in adherence to the GRI guidelines.³⁷ Chapter 2 provides further discussion on the sustainable organisation and the importance of stakeholder relationships.

In addition to sustainability, the other main issues included in contemporary business models are the ability to attain a competitive advantage through value innovation using blue ocean strategies in which uncontested market spaces (where no competitors exist) are identified; stakeholder engagement; governance and ethics; a focus on global strategies where the winner takes the market; multiple connections; and the generation of multiple scenarios (see Table 1.2). Increasingly the focus is shifting from structure to process. Multiple connections refer to the 'interconnectedness between markets and the constant intensifying diversifying of economic exchanges worldwide'.³⁸ The concept of multiple connections or interconnectivity is driven by the unpredictability and constant change caused by volatility in the marketplace.³⁹ 'Digital technologies are re-engineering how industry works, channelling the power of the cloud into the Internet of Things (IoT), and revolutionising how we experience and interact with everything around us' ... 'organisations need to be agile, innovative' and open to the external environmental changes to deliver what their customers want as well as envisioning their future demands (multiple scenarios). As such, the value propositions are constantly changing⁴⁰ and the principle of strategic action and reaction becomes vital to ensure that the organisation's strategy is appropriate.⁴¹ With regard to this principle, we argue that while organisations need to internalise the impact of the external environment and the role of increased connectedness in their strategy implementation, simultaneously there is increasing pressure to also consider their socio-ecological impact on communities and environments, especially in developing countries. According to Robert Kaplan, a professor at the Harvard Business School, it does not mean that strategy needs to be changing every year but that 'you need to have a true north for your organisation where you have position for competitive success'.⁴² From the authors' perspective, we assert that while strategising often responds to innovative disruption, often caused by technology changes, it can also follow a blue ocean strategy that is regarded as a non-disruptive creation. Blue ocean strategies, elaborated on in Chapter 9, focus on value innovation. In creating value innovation, a blue ocean strategy considers both the organisation's cost structure and the value proposition it offers to its customers. In essence, in creating value, an organisation's strategy can be very competitive and disruptive by 'focusing on displacing existing players and markets with superior products' or services. On the other hand, an organisation's strategy could be to 'create new markets without disrupting existing ones', thus following a blue ocean strategy.⁴³ AutoTrader, operational in South Africa since 1992, used disruptive innovation to generate blue ocean strategies that were non-disruptive in nature. This example is further discussed in section 1.5.

The concept of multiple connections is illustrated with examples from Cisco and Philips, Ford Motor Company and BSK Marketing in South Africa.

CASE EXAMPLE: How multiple connections create value⁴⁴

The collaboration between the IT giant Cisco and Philips Lighting is illustrative of multiple connections between two organisations. By combining Philips' Ethernet-powered and connected systems with Cisco's networking know-how, the next generation of lighting will improve energy efficiency, enhance user environment, and can be controlled by a smartphone. Philips' cloud-based CityTouch software platform enables urban managers to analyse data, fix problems and control street lighting networks in real time. According to Eric Rondolat, CEO of Philips Lighting, '[i]n the future, connected street lighting could form the digital backbone of smart cities'. Furthermore, Tony Shakib from Cisco emphasises that connectivity is also 'about productivity. When you connect your assets, you can see how they are performing'.

Similarly, Ford Motor Company is shifting its value proposition and business model from being an auto manufacturer towards becoming a manufacturing technology and information organisation where innovation is core. Ford is not merely looking at producing cars but also at providing other services to address different transportation needs. To achieve this shift, they realised that they needed to disrupt their current business model by considering societal trends over the next 15 years and the impact on human health. Instead of just counting the number of cars sold, Ford will explore how people move in the future, from car- and ride-sharing to developing connectivity to self-driven vehicles. For example, in London they launched their GoDrive scheme. In this scheme, the GoDrive app lets users locate hubs, pick up an electric Focus or low-emission Fiesta, pay per minute to drive with no mileage limits, and drop the vehicle off in a guaranteed parking space on arrival. This app illustrates the connectedness between users and multiple ride-sharing activities, all made possible because the Ford Motor Company is using next-generation technology and information.

Busi Skenjana, CEO and founder of BSK Marketing, *Stokvel Voice* magazine and the Stokvel Academy, focused on 'unlocking the stokvel market and forming strategic partnerships between government and private' enterprise. In addition, she understood what the stokvel market's unique challenges were and how to offer solutions to market needs. Marketers did not understand stokvels or how the community works, particularly because stokvels exceed traditional socio-economic lines. Skenjana saw the opportunity of bringing together different groups of people with different needs who could benefit from each other but do not necessarily have access to each other. As such, *Stokvel Voice* provides niche information on topics such as 'finance, legal, health, home improvements, parenting and fashion'. Skenjana is using the principle of multiple connections between government and private enterprise, and is satisfying the multiple needs of different groups of people by including niche information in *Stokvel Voice* on various aspects. Uber and Airbnb also use a similar business model by linking 'people and product or service'.

This section provided an overview of how strategy developed during the 20th century and into the 21st century. The next section expands further on the nature and role of strategy.

1.3 The nature and role of strategy

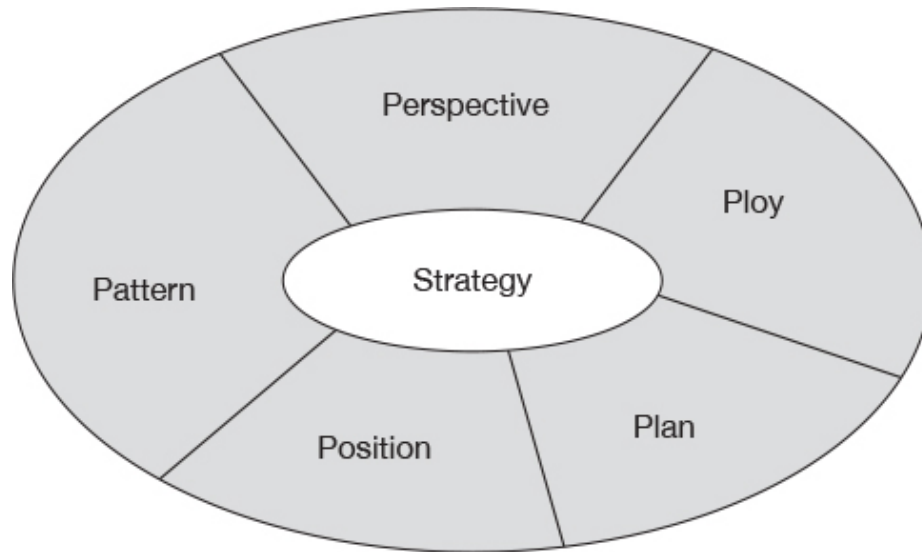
This section explains the nature of strategy by considering Mintzberg's⁴⁵ five Ps of strategy. The role of strategy will be dealt with in terms of an explanation of the levels of strategy in an organisation.

1.3.1 The five Ps of strategy

Before discussing the five Ps of strategy (strategy as a plan, position, perspective, ploy and pattern), as shown in [Figure 1.1](#), it is important to understand that these five Ps provide insight into how strategy is defined by the different perspectives and processes used in formulating and implementing strategy. While each P provides a specific definition of strategy, no one definition takes preference over the other, and they should all be seen as being complementary and interrelated, for example the relationship between strategy as a plan and strategy as a perspective. As a plan, strategy has traditionally been viewed as something an organisation 'has' in setting direction, while strategy as a perspective is seen as something that people in an organisation 'do', i.e. the practice of strategy.⁴⁶

In turn, the practice of strategy is influenced by the practices (how things are done) external to the organisation (extra-organisational) and the activities (what is done) of people in the organisation (intra-organisational).⁴⁷ There is a reciprocal relationship between intra- and extra-organisational strategic activity. However, this relationship is influenced by what people do (their activities). The activities of people influence the way in which strategy is implemented.

Figure 1.1 The five Ps of strategy



The five Ps of strategy are as follows:

- *Strategy as a plan* provides overall direction and a course of action. The planning viewpoint or ‘design school’ of strategy⁴⁸ views strategic decision-making as a formal, logical, top-down structured process in which strategy is formulated by means of a rational analysis of the organisation, its performance, and external environment. As a plan, strategy formulation is a formal process of conception⁴⁹ implemented through organisational layers, structure and control systems. In this approach strategy is *intended*, as it looks and seeks to attain a match or strategic link between the internal organisational capabilities and external opportunities, forming the basis of the sustainable resource-based and dynamic capabilities perspective discussed in [section 1.5.1](#). The planning approach to strategy has been criticised for being a too rational, top-down management approach, and for not being realistic enough given the unpredictability of the 21st century competitive environment. However, research suggests that formal planning systems contribute towards better strategic decision-making, and have a positive impact on organisational performance.⁵⁰
- *Strategy as a position* concerns the determination of particular products in particular markets⁵¹ – a matching of the external and internal environments. As a position, strategy looks downwards (meeting customer needs) and outwards, towards the external competitive market. The focus is on an outside-in perspective (see [section 1.5.2](#)).
- *Strategy as a perspective* refers to the organisation’s way of doing things, and is also called the interpretative view⁵² or experience.⁵³ Future strategies are formed by adapting past strategies based on the collective experience of individuals and the way of doing things embedded in the cultural web of an organisation. It is a product of the minds and ideologies of individuals, groups and management in the organisation. Resolving different views and experiences requires negotiation and bargaining. In other words, the extent to which the strategic link is attained between the organisation and its competitive environment is mediated by how individuals and management interpret the internal resources and capabilities in the environment. As a perspective, strategy looks inside the organisation – inside the mindset of the collective strategists – and upwards

toward the strategic purpose, intent and direction of the organisation.⁵⁴ Strategy as a perspective is becoming more important in developing a competitive advantage by creating better value propositions through people and processes. The focus is on an inside-out perspective (see [section 1.5.1](#)).

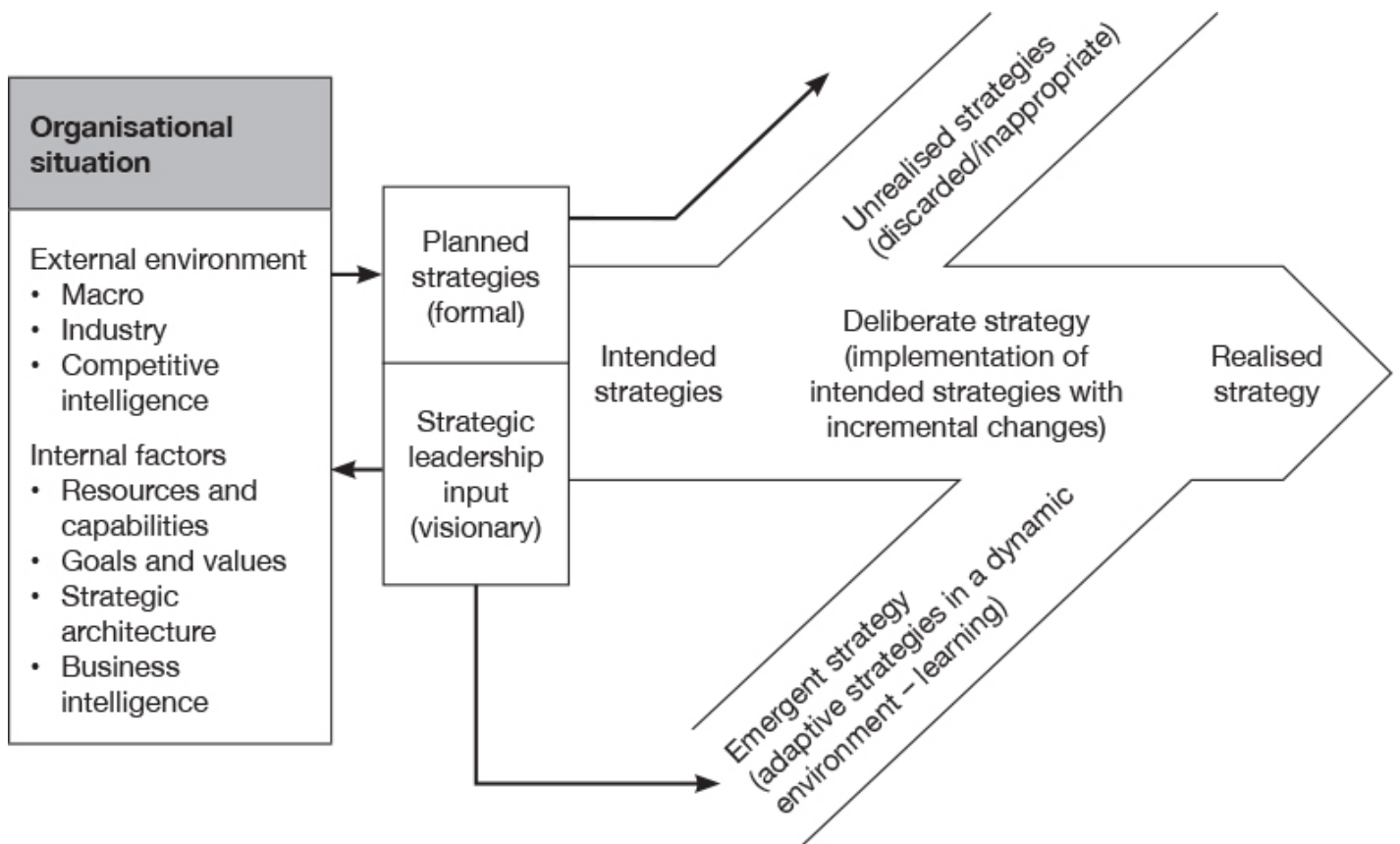
- *Strategy as a ploy* is a specific manoeuvre to outwit a competitor. For example, to give the impression of expanding capacity, an organisation may purchase land to discourage a competitor from building a new plant. The real strategy is not the expansion itself, but the threat or ploy.
- *Strategy as a pattern* concerns consistent behaviour over time. For example, an organisation that perpetually markets cheap products pursues a low-cost strategy.
 - » While strategy as a plan is intended, strategies as a pattern evolve over time as a ‘pattern in a stream of actions’.⁵⁵ Strategy as a pattern encompasses a series of behaviours that result in a strategy, whether intended or not. For example, the *realised strategy* at Ford Motor Company was to produce the Model T Ford only in black. While realised strategies do not always arise from intended strategies, in this example it was an intended strategy of Henry Ford. Intended strategy is the strategy envisioned by top management and is achieved by managers shaping and reshaping strategies as circumstances dictate, and as they learn from experience and seek out improvements. Only 10–20% of intended strategies are realised.⁵⁶ Intended strategies that are fully realised are referred to as *deliberate strategies*, and those that are not realised, mainly due to unpredicted change, are called *unrealised strategies*⁵⁷ or *abandoned strategies*.⁵⁸
 - » When the pattern realised is not explicitly intended, it is referred to as an *emergent strategy* (see [Figure 1.2](#)). Emergent strategies are ‘the patterns of decisions that emerge from individual managers adapting to changing external circumstances and the ways in which the intended strategy is interpreted’.⁵⁹ Such strategies are unplanned responses to unforeseen circumstances. They are neither a product of formal top-down planning nor a bottom-up approach, but rather a ‘fuzzy and intuitive process of understanding’.⁶⁰ For example, rather than pursuing a comprehensive diversification strategy, an organisation may first test the market by purchasing a restaurant, then a resort hotel, and then an urban hotel, until a strategy pattern of diversifying into urban hotels with restaurants emerges.⁶¹

To summarise, the challenge for organisations is to maintain a balance between deliberate and emergent strategies. This is associated with the strategic paradox and is discussed further in [section 1.8](#).

The most classic case of strategy as a pattern is the Honda Motor Company’s entry into the US motorcycle market.⁶² The conventional explanation of Honda’s success is that it redefined the US motorcycle industry with a well-conceived intended strategy. Despite the fact that Honda’s strategy was close to disastrous, the Japanese management astutely and flexibly responded to unforeseen circumstances. Honda’s reaction was unplanned, and emerged as circumstances changed.

An important lesson for strategists is that they need to recognise the process of emergence and intervene where appropriate. They need to realise that strategies can grow from any point in the organisation, provided people have the capacity to learn and the resources to support that capacity. Eighty percent of the success of world-class organisations can be attributed to the implementation of emergent strategies – ‘the trick is to co-ordinate the 101 little things that make the idea happen’ rather than the major innovative ideas.⁶³

Figure 1.2 Deliberate and emergent strategies



Management is responsible for evaluating the appropriateness of emergent unplanned strategies. As illustrated in Figure 1.2, management does this by comparing the emergent strategy with the organisation's external environment and internal factors to assess whether there is a strategic link between them, and whether there is alignment with the organisational purpose.

It is normal for organisations to pursue an umbrella strategy in which broad outlines are deliberate, while the details emerge within, provided learning takes place.⁶⁴ Figure 1.2 illustrates that it is normal to find deliberate and emergent strategies simultaneously in an organisation.

Despite the differences highlighted in this discussion on the essence of strategy, there are also some areas of agreement.⁶⁵

- Strategy is concerned with the organisation and its environment.
- Effective strategies are important to ensure value creation for all stakeholders and above-average earnings for the organisation.
- Strategy sets direction, focuses effort and provides consistency.

The essence of strategy is complex and unstructured. Strategies can be deliberate, intended but unrealised, or emergent, and exist on different levels, namely corporate, business and functional, as discussed in the next section.

1.3.2 Levels of strategy

As mentioned previously, primary objective of strategy is to achieve a sustained competitive advantage as this leads to above-average returns (increased profitability). However, once an organisation has analysed, developed and formulated its strategy, it needs to implement and manage risk to ensure that strategy successfully. The overall

strategy is the collection of the strategic initiatives and actions developed by managers and key employees, in the organisational hierarchy, as discussed below and illustrated in [Table 1.3](#):

- *Business level strategy* relates to how the organisation competes to strengthen its market position and attain a competitive advantage in each area of its business units. The strategic link between internal capabilities and external relationships is important.⁶⁶ The business unit head is responsible for orchestrating business level strategy; for ensuring that lower-level strategies are well-conceived, consistent and match the corporate level strategy; and for obtaining approval by corporate level executives and the board of directors.⁶⁷ [Chapter 8](#) examines business level strategy in detail.
- *Corporate level strategy* relates to the overall purpose and scope of an organisation. It addresses the question of how value can be added at all business levels and lines. General decisions about what type of business the organisation conducts, or ought to be conducting, are taken at this level. This could include aspects such as geographic coverage, diversity of products or services, turning cross-business into competitive advantage, and divestments.⁶⁸ The CEO and senior managers are normally responsible for orchestrating corporate strategy, with input from the key senior executives who head up the business.⁶⁹ The CEO is responsible to all stakeholders. The organisation's board of directors usually reviews and approves corporate level decisions. Consider the Opening case study of Shoprite Holdings Ltd as an example. Shoprite has a diversified portfolio of businesses that are active in four segments, namely Supermarkets RSA, Supermarkets Non-RSA, Furniture, and Other Operating segments. The company is also the largest private sector employer in South Africa and a major employer in the rest of Africa with approximately 143 000 employees. They currently have 308 outlets in 15 other African and Indian Ocean islands, and are also planning to further expand into the African continent and Eastern Europe. Their success resides in their ability to maintain their position as a market leader, and deliver on their low-cost promise and value proposition across diverse locations in Africa. To do so, the CEO of Shoprite Holdings Ltd must provide the strategic direction and is responsible for setting the overall strategic goals, allocating resources, driving the value proposition and deciding on international strategies. He is responsible for managing the corporate portfolio of businesses to have above-average returns. Corporate level strategy is further discussed in [Chapter 10](#), while [Chapter 11](#) discusses strategies for international competitive advantage.
- *Functional level strategy* (discussed in [Chapter 13](#)), which includes operational level strategy, underpins business level strategy by implementing business strategies through the functional areas, such as marketing, human relations, production, information systems and finance. The primary role of functional strategy is to support the overall business strategy and competitive approach by performing strategy-critical activities.⁷⁰ The decision-making responsibility, at functional level, resides with the heads of the respective functional areas, and with the general manager, at business level, who approves the content of these strategies. Often the links between business level and functional level strategy are tenuous. If there is no clear direction at business level, functional level strategies are unlikely to be mutually supportive and consistent. There should be synergy and cooperation between the functional areas in an organisation to achieve a competitive advantage.

[Chapter 14](#) discusses operational and strategic risk management relevant to all the levels of strategy.

Ideally, cohesion should be achieved between these three levels of strategy. Cohesive strategy-making becomes easier to achieve when all the organisational members, at different levels, understand the organisation's strategy as a result of clear communication and guiding principles.⁷¹ In [Table 1.3](#), the strategic perspective, key questions and decision-making responsibility for each level of strategy are given.

1.4 Strategic management

The success of an organisation is mainly determined by the effectiveness and efficiency of its management. In the words of Peter Drucker,⁷² efficiency is concerned with ‘doing things right’, while effectiveness is concerned with ‘doing the right things’. Effectiveness is associated with strategic management, while efficiency is related to operational management.

Strategic management is concerned with the overall effectiveness and choice of direction in a dynamic, complex and ambiguous environment. Strategic decisions have long-term implications and concern the entire organisation. Strategic management encompasses more than strategic decision-making and the strategic planning process. It has to ensure that strategy is implemented, i.e. that strategies are working in practice. In other words, strategic management refers to the management processes that define the organisation’s goals for value creation and distribution, and design the way the organisation will be composed, structured and coordinated in pursuing its goals for value creation and distribution.⁷³ It is the process by which organisations determine what value is needed and how to add that value, and enables organisations to cope effectively with the myriad demands placed on them both internally and externally.

Table 1.3 Levels of strategy and decision-making hierarchy

Strategy levels	Strategic perspective	Key questions	Decision-making responsibility
Corporate strategy	Overall purpose, scope, range, and diversity of the organisation – organisation as a whole perspective	• What is the purpose of the organisation? • What type of business are we conducting? • What business should we be conducting? • What is our overall direction for the future? • What is our leadership style and organisational culture? • What is our attitude towards strategic change?	Orchestrated by the CEO or MD, other senior executives and the board of directors
Business strategy	Determining competitive strategy and achieving competitive advantage for a single line of business – business, product or service	• What is our sustainable competitive advantage? • What value do we add? Where? Why? How? • What markets should we compete in? • What competencies and capabilities do we need? • Who are our customers? • How can we innovate?	Orchestrated by the general manager of each line of business, with advice and input from the heads of functional areas in each line of business

Strategy levels	Strategic perspective	Key questions	Decision-making responsibility
Functional strategy	Source of competitive advantage in a particular activity or line of business – functional level activities, processes, practices and resources	• What is the role of this department or functional area in delivering business level strategies? • How is strategy implemented and coordinated at functional level? • Does the organisational architecture support strategy implementation?	Crafted by the heads of functional division within a particular line of business with the involvement of key employees

Source: Thompson et al. 2004. *Op. cit.*: 27; Thompson et al. 2016. *Op. cit.*: 33

From the authors' perspective, strategic management is concerned with:

- *Strategic planning* or the thinking aspect of strategy. Strategic planning is concerned with:
 - » sustainable stakeholder context
 - » analysing the external and internal organisational environments, supported by strategic decision-making
 - » developing and formulating effective strategies that balance the organisation's internal and external environments.
- Strategic planning is supported by strategic decision making, risk management and strategic leadership.
- In doing so, strategic managers are responsible for establishing a clear direction for the organisation and a means of getting there, which requires the creation of strong competitive positions through their value proposition. This might mean a change in the business model.
- **Strategy implementation** or the doing aspect of strategy. In effective strategy implementation, the **organisational alignment through its architecture** (i.e. processes, structure, systems, knowledge, skills, abilities, technology and organisational culture), leadership activities, supported by strategic risk management are synergistically integrated to achieve effective performance.
- *Integrating sustainability* into all the strategies.

Note, however, that strategic management per se based on past and current success will not guarantee continued prosperity and success.⁷⁴ Constant organisation-wide learning, visioning of the future, strategic flexibility to deliver, and a team approach towards employees and stakeholders are required to sustain prosperity and establish a competitive advantage. The primary objective of strategic management is to achieve a sustainable competitive advantage for the organisation. This can be achieved only if strategy is formulated and implemented properly.

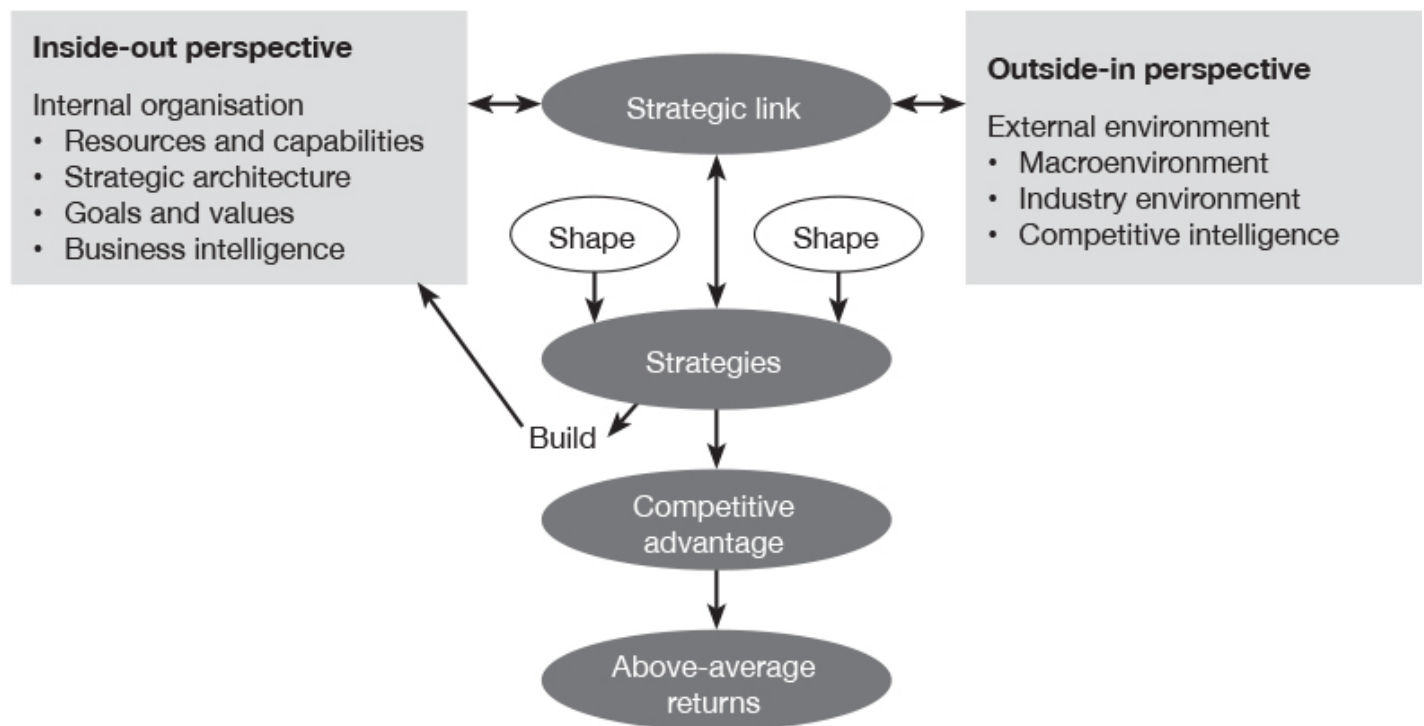
Good strategic management = good strategic planning + good strategy implementation

To position an organisation strategically, there needs to be a conceptual fit, or a strategic link, between the internal and external environments. Matching the conditions of the internal and external environments is the foundation on which the organisation needs to develop its strategic direction, plan strategically and implement strategies and manage risk in the pursuit of strategic competitiveness, i.e. sustainable and above-average returns. The next section discusses the inside-out and outside-in perspectives that explain how to achieve a strategic link between these two environments.

1.5 Perspectives on managing strategically

To achieve a competitive advantage, strategy has to be consistent with the organisation's internal and external environments (**macro-** and industry environments). Our perspectives for managing strategically, as illustrated in [Figure 1.3](#), view strategy as a link, or conceptual fit, between the organisation's internal environment (referred to as the inside-out perspective) and its external environment (referred to as the outside-in perspective). Successfully attaining this strategic link will shape the strategies formulated, which will lead to a competitive advantage and above-average returns, and potentially a revised business model. Well-developed and well-formulated strategies will build and reinforce organisational resources and capabilities, strategic architecture, and goals, values, and business intelligence to generate new value propositions. According to research, approximately 20% of an organisation's variance in profitability can be explained by the industry in which it competes, while 36% could be attributed to its internal environment.⁷⁵ This suggests that there is a reciprocal relationship between the external and internal environments in shaping the competitive advantage of an organisation and its above-average returns. The next section discusses the inside-out and outside-in perspectives to explain what is meant by the conceptual fit between an organisation's internal and external environments.

Figure 1.3 Strategy link perspective



1.5.1 The inside-out perspective

Strategic leaders who adopt an inside-out perspective believe that strategies should be designed and developed around the organisation's resources, dynamic capabilities, and strategic architecture, goals and values,⁷⁶ as well as being able to convert business intelligence into useable knowledge⁷⁷ to take advantage of the opportunities in the external environment.⁷⁸ This is known as strategic stretch, as shown in [Figure 1.4](#). From this perspective, the organisation leverages its resources and **dynamic capabilities** by 'stretching' its resources and capabilities to achieve a competitive advantage and/or yield new opportunities. The organisational resources and capabilities are discussed further in [Chapter 7](#). The ability to be innovative (discussed further in [Chapter 9](#)) and strategically flexible is critical to achieving a competitive advantage. The resource-based and dynamic capabilities viewpoints form the basis of this perspective and are explained below.

1.5.1.1 Resource-based and dynamic capabilities viewpoints

The answer to the question: ‘What can this organisation do for me?’ usually lies in the organisation’s resources, which are at the core of the resource-based viewpoint (RBV). The RBV is a theoretical perspective for understanding how competitive advantage is achieved in organisations and sustained over time. This view assumes that organisations are conceptualised groupings of resources that are heterogeneously distributed across the organisation and persist over time. An organisation can use its unique resources to implement value-creating strategies and to exploit new market opportunities.⁷⁹

The perspective taken in this text is that a sustainable organisation can be achieved by formulating and implementing value-creating strategies while concurrently considering the urgent social and environmental problems facing the global community. When an organisation implements value-creating strategies that other competitors are unable to duplicate, or are too costly to imitate, it has achieved a competitive advantage.⁸⁰ A competitive advantage and above-average returns are easier to attain when an organisation has resources that are valuable, rare, costly to imitate and non-substitutable, i.e. unique.⁸¹ In this sense, strategy is neither a quest for the universally best way of competing nor an effort to be all things to every customer, but rather how the organisation competes to deliver unique value.

The term value used here refers to the contribution that strategic leaders make to their organisations, products, customers and stakeholders. An organisation creates value through flexibility and innovation. Strategic flexibility implies that the organisation has sets of capabilities in different areas of operations that add value to how it responds to external opportunities and challenges in a dynamic and uncertain environment.⁸² Competitive advantage can be achieved only when the organisation’s products or services are perceived as having value, determined by customer acceptance. The key challenge is to sustain the competitive advantage. A competitive advantage can only be sustained for a certain period, given the speed with which competitors are able to copy value-creating capabilities.⁸³ For example, Kodak, founded in 1888 by George Eastman, almost lost its competitive advantage by focusing on film technology for too long. In 2004, declining consumer film sales forced the company to restructure to accelerate its digital transformation.⁸⁴ Unfortunately Kodak went bankrupt in February 2012 and exited the camera business.⁸⁵ The company, Eastman Kodak Co, emerged from this bankruptcy in 2013 as a smaller company in the printing industry, showing a profit in 2016. and has a new business model that is technology-based and able to adapt to changes in the external environment more quickly.⁸⁶

Owing to the current competitive environment of rapid and unpredictable change, the emphasis has shifted towards an organisation’s capabilities rather than its resources. Consequently, the competence-based view and capabilities-based view have gained in popularity. Core or **distinctive capabilities** are distinctive skills that yield a competitive advantage, and are difficult for competitors to imitate or obtain. Distinctive capabilities are inherent in the technologies, processes, strategic architecture,⁸⁷ combination of strategies, values and relationships⁸⁸ in an organisation. Building onto the RBV, distinctive capabilities are process-based (internal processes such as coordinated activities that rely on sets of activities and resources simultaneously) and higher-order competencies (the ability to think critically).⁸⁹

The ability to stretch resources and capabilities is largely dependent on the organisation’s strategic architecture.⁹⁰ Organisational architecture, further explained in [Chapter 13](#), integrates the key dimensions of the organisation, such as organisational structure, leadership, organisational culture, policies and strategies, to guide strategy formulation, alignment and implementation. The ability to manage architecture strategically is supported by effective functional processes and strong technological capabilities:

- *Internally*, organisations must behave in a coordinated manner that creates synergy by integrating functions, systems, processes, people and structure, i.e. sustainable systems thinking. For example, AutoTrader (see the

Strategy in action feature in [section 1.5.2](#)) connected automotive buyers and sellers on their digital platform which assisted them in building a new value proposition. In creating value, they developed a free call-tracking system for their car dealers enabling them to interact directly with buyers. The value proposition was further enhanced by the leveraging of data into useable knowledge that enabled AutoTrader to further enhance their service offerings to meet the needs of their customers. To achieve this, the functional specialists met regularly to create sustainable synergy between functions, systems, processes, people and structure.⁹¹

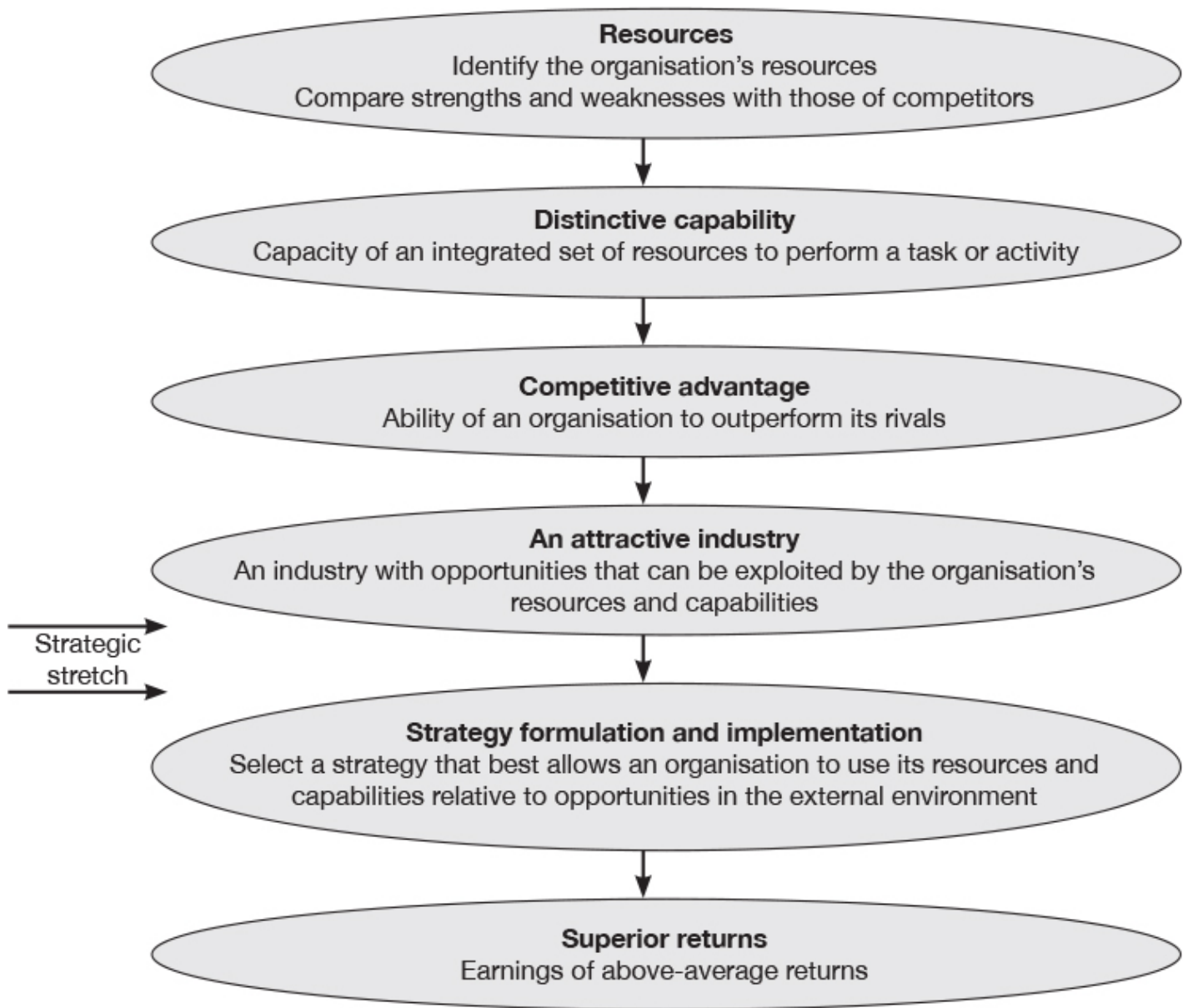
- *Externally*, integrating value-adding networks contribute to adding value in the value chain. For example, Woolworths ensures that its supply chain operates smoothly to deliver a good service to its trade partners and its stores by focusing on vendor capability, packaging and barcodes, primary freight, distribution centres, timely replenishment and international logistics.⁹²

Dynamic capabilities are activities and processes that strategic leaders employ to integrate, build and reconfigure internal and external competencies to address rapidly changing environments, and which become the source of sustained competitive advantage.⁹³ They are the drivers behind the creation, evolution and recombination of other resources into new sources of competitive advantage,⁹⁴ and cut across the entire organisation. Examples are Michelin's complex technological process in manufacturing radial tyres, and Coca-Cola's specialised marketing and merchandising know-how.

However, resources and capabilities can become a threat to an organisation if they are lost or diminished, or too entrenched to change quickly enough. In other words, if the factors that contributed towards a competitive advantage become too entrenched into modes of thinking and working, under conditions of change they could lead to the downfall of an organisation. The main cause of a downfall is usually the 'inability to take appropriate action ... [with] reasons ranging from managerial stubbornness to sheer incompetence – but one of the most common is a condition called active inertia. Active inertia is an organisation's tendency to follow established patterns of behaviour – even in response to dramatic environmental shifts.'⁹⁵

[Figure 1.4](#) illustrates the importance of resources and capabilities as initiators of superior returns.

Figure 1.4 Inside-out perspective of superior returns⁹⁶



An organisation can build on its internal resources, such as technological infrastructure and know-how, and capabilities, for example IT capabilities, to take advantage of external market forces. For instance, the strategic decisions made by Nokia to turn the organisation around amidst strong competitors such as Apple, Google and Samsung were successful over a number of years. They were able to leverage their internal resources and capabilities until new challenges arose. Some of these new challenges included their ability to move from a device-centric to a platform- and application-centric system; and to become more software and application ecosystem orientated.⁹⁷ In the constant restructuring to respond to 'technological advancement, rapid market change and growing complexity',⁹⁸ there were a number of internal mistakes that contributed towards their decline. These included decisions by management, a dysfunctional organisational structure, increasing bureaucracy, internal rivalries⁹⁹ and overestimation of their brand value. Nokia sold its mobile phone business to Microsoft for \$7.2 billion in 2013, but retained its other businesses.¹⁰⁰

In adopting an inside-out perspective in the new era of innovation, an organisation's core expertise is more important than ever before. Data, turned into intelligence, will become the most powerful asset, and being able to

build or participate in platforms is vital to a sustained competitive advantage.¹⁰¹ The resource-based and dynamic capabilities viewpoints suggest that an organisation's unique resources and capabilities are the critical link to sustained competitive advantage and above-average returns. However, failure to match the organisation's resources and capabilities with the external environmental factors could be a critical error.

1.5.1.2 The importance of goals and values

The importance of goals and values cannot be ignored. In this text, values have a wider meaning than mere ethical connotations. We define **values** as the standards by which all employees set priorities and define the rules that they should follow to achieve a sustainable competitive advantage. In doing so, employees at every level, not just at the strategic top level of management, make prioritisation decisions regarding what is attractive or unattractive, or more or less important.

Given the hyper-competitive 21st century environment, a new mindset emerged in which values such as flexibility, speed, innovation and integration are pertinent. A key method for determining 'good' strategic management is to assess whether clear and consistent values have filled the organisation.¹⁰² As mentioned in [section 1.3.1](#), while creating a culture that can embrace and adapt to technology change is critically important, but it needs to be supported by the appropriate value system of employees at every level in the organisation. Likewise, the Nokia example emphasises the importance of values and organisational culture. Some argue that the lack of similar values and the ability to manage the organisation's emotions in a collective (emotions felt by people can influence strategy implementation) was one of their downfalls.¹⁰³ As mentioned previously, being able to create an organisational culture and values that embrace and adapt to change is the most important resource for coping with disruptive innovation.¹⁰⁴ Just as important is the access to, and use of, business intelligence systems that provide structured, quantitative and historical information about the organisation. [Chapter 4](#) discusses the analysis of this information by means of organisational integrating mechanisms (people, technology and processes) facilitating effective strategic decision-making.

In conclusion, the factors that define an organisation's internal capabilities evolve over time. These factors begin with resources, and then move to visible, articulated processes and values, using business intelligence as a strategic decision-making enabler, and finally becoming ingrained in the organisation's culture. Being flexible and ensuring the strategic link between the inside-out and outside-in perspectives is a challenging strategic task.

1.5.2 The outside-in perspective

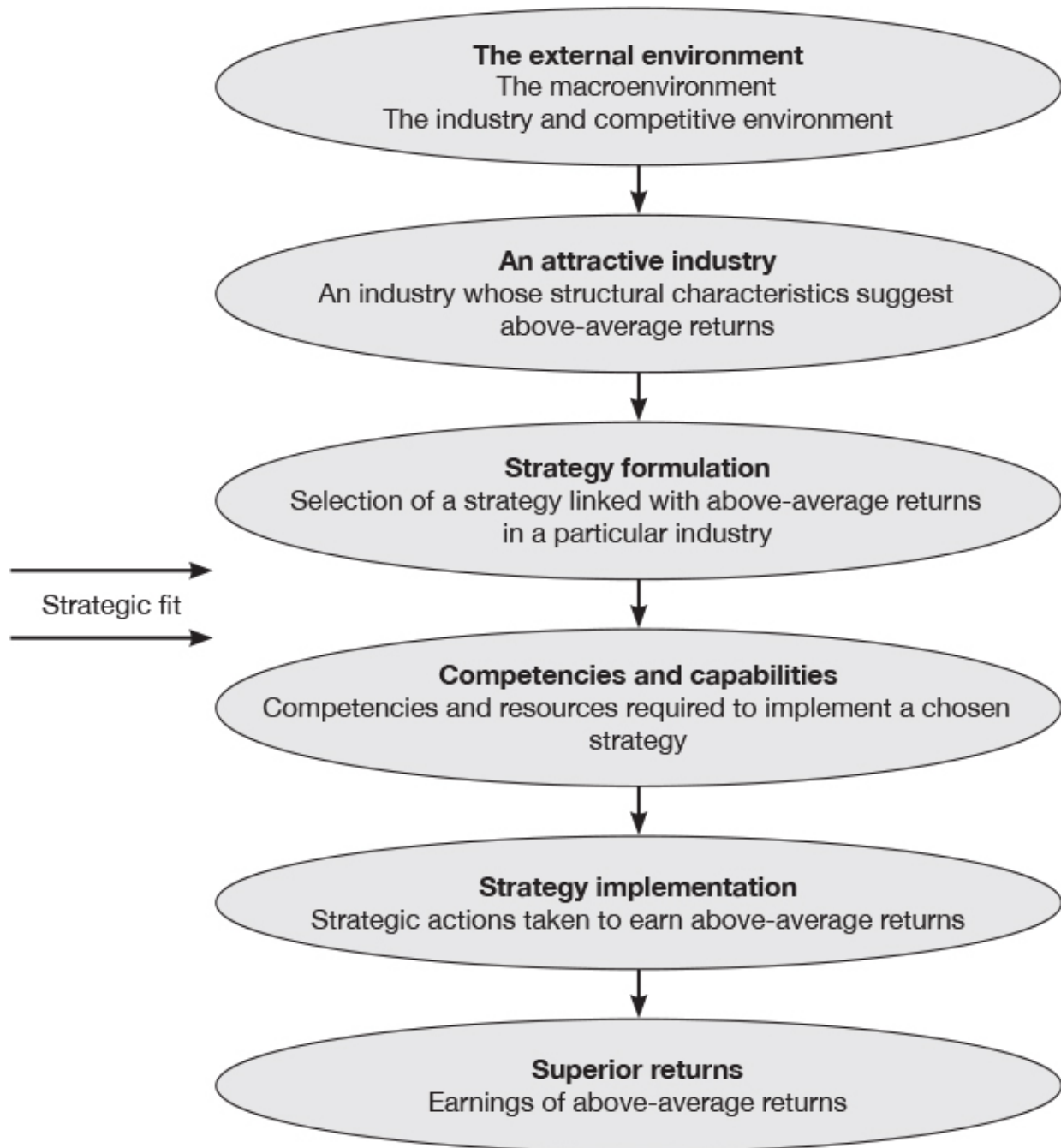
The *outside-in perspective* is also referred to as the market-driven strategy¹⁰⁵ and the industrial organisation model.¹⁰⁶ Strategic leaders who adopt an outside-in perspective believe that strategies should be designed and developed as determined by market needs, and based on an understanding of and response to the external environment. From this perspective, the organisation:

- Identifies opportunities in the external environment
- Creatively defines its competitive industry, facilitated by environmental scanning activities known as competitive intelligence
- Adapts its resources and dynamic capabilities to take advantage of these opportunities. This is known as *strategic fit*.¹⁰⁷

The key to this perspective is competing successfully in an attractive industry, with the external environment as the initiator of strategy. This requires the organisation to develop new resources and dynamic capabilities to establish a competitive advantage. Alternatively, the organisation can create new opportunities by forming strategic alliances with organisations that have superior resources. In [Figure 1.5](#), the outside-in perspective suggests that above-average

returns are earned when the organisation develops, or acquires, the internal resources and dynamic capabilities needed to implement strategies as dictated by the external environment. Examples of organisations that were not able to adapt their dynamic capabilities to fit strategically with the demands of the external environment are Kodak and Nokia. For further information refer to <http://www.kodak.com> and to Doz, Y. (2017) The strategic decisions that caused Nokia's failure. December, 4. <http://www.leader.co.za/article.aspx?s=6&f=1&a=6837>

Figure 1.5 Outside-in perspective of superior returns¹⁰⁸



Chapters 5 and 6 discuss the external environment, as the initiator of strategy according to the outside-in perspective, consists of the macro- and industry environments while Chapter 4 discusses an organisation's ability to scan the competitive environment using competitive intelligence as a strategic decision enabler.

One example of how the external environment affected a company's competitive actions and responses is found in the Strategy in action section on AutoTrader, below, who positioned themselves for sustained growth in the digital market of buying and selling cars.

STRATEGY IN ACTION: AutoTrader¹⁰⁹



AutoTrader South Africa, a subsidiary of the UK holding company, has been operational in South Africa since 1992. The CEO of AutoTrader South Africa, George Mienie, joined the organisation in 2004. AutoTrader in South Africa experienced a boom in the sales of their magazine during 2005 to 2008. In 2007 they sold 108 000 copies of the magazine each month, prior to the unforeseen recession and the exponential change (disruptive innovation) from print to digital.

George and his team decided to change their business model as they recognised that the market was changing and that their current business model would not support sustainable growth. They decided on a business model that focused on digital rather than only on print platforms, despite the fact that in 2007 the market need in South Africa was satisfied with print platforms. In changing their business model 'two key areas had to be addressed. First, the team needed to determine how a digital business could potentially eradicate the limitations of print. Second, they needed to understand the customer and their needs, which would inform what AutoTrader's new products should deliver'. It was difficult for AutoTrader to envision the scope that digital offered, as print business offered a limited scope and there was no further room for scalable growth. Increasing print readership in an existing market, or expanding the market into different geographical areas, would not provide opportunities for scalable growth in the future, and the sustained competitive advantage would slowly become eroded by the emergence of the digital platforms. In this case the emergence of the digital platform represented a disruptive innovative opportunity for AutoTrader to change their business model. In doing so, they had to consider three important points. Firstly, changing a business model from an extremely successful one to an unknown one is risky. Secondly, besides focusing on what their customers needed, they also had to find out what their customers wanted. 'In many instances the customers do not know what they want until you give it to them.' Thirdly, they had two sets of customers, namely those who were readers (potential car buyers) and those who were selling cars (the advertisers).

As such, they had to understand what their value proposition would be to their customers. More specifically, AutoTrader had to understand what the needs and wants of their car sellers and buyers were. In meeting their customers' needs and wants, they had to design a call tracking system to make their value proposition attractive to their customers using the online digital platform. In addressing the needs and wants of the car sellers, George and his team were able to build on their dynamic capabilities to design a 'call tracking system that we gave to all our car sellers for free, with one telephone number and a line that we paid for. The number was printed on their magazine adverts' so that they were able to track the incoming calls based on the adverts. AutoTrader 'is one of the few companies worldwide that has successfully transitioned all of its clients onto a call tracking system'. In building their value proposition, '[t]he key lesson was in understanding what a digital product should look like ... and understand[ing] and defin[ing] who you are'. For AutoTrader this was the 'two-sided marketplace for buying and selling cars. Everything else was secondary.' Both sides of the marketplace could be tracked, and they could do business with each other through AutoTrader. Besides selling the magazine online, they developed specific products for car sellers at 'different prices with different value propositions. 'To ensure that online advertisers on different packages received value, data was continuously collected and monitored, and online packages adjusted to deliver the best results for buyers and sellers.' This was a process that took time, and the product offerings often had to be modified.

AutoTrader South Africa made the decision to be proactive and to be an industry leader ahead of the innovation curve. In so doing, they positioned themselves for sustained growth in the 'digital market of buying and selling cars'. They became content creators, brought together buyers and sellers on one online platform, and converted data into knowledge to create value propositions for their customers. They were able to innovate and create a new market space of connectedness within their own market – the essence of a blue ocean strategy.

Currently 'AutoTrader.co.za's online customer base is exponentially greater than the size of its print readership at its height'.

According to the CEO, implementing the strategy is more important than the innovative ideas as it is important to constantly stay ahead of the innovation 'S' curve.

Questions

1. Outline how AutoTrader was able to adapt their dynamic capabilities to strategically fit the demands of the external environment. Refer to this article for additional information:
<https://www.entrepreneurmag.co.za/advice/success-stories/case-studies/how-autotrader-anticipated-change/>
2. Explain how AutoTrader applied the principles of strategic action and reaction and market interconnectedness, introduced in [section 1.2.3.2](#).

It is evident that AutoTrader, despite not being fully aware of what the future might hold, was able to stay ahead of the innovation curve, understood the need for change, analysed the market correctly and implemented the required changes in their business model. The Strategy in action case study illustrates how they were able to adapt their dynamic capabilities to **strategically fit** with the change in technology and market needs. It also illustrates the principles of strategic action and reaction and market interconnectedness, introduced in [section 1.2.3.2](#).

Whether intentionally or not, AutoTrader applied a blue ocean strategy as they created a new market space in their current automotive industry by changing their business model to a digital platform triggered by disruptive innovation. In turn they were able to use a blue ocean strategy in a non-disruptive manner rather than competing with competitors head on. In redesigning their business model, they were also able to create value through a blue ocean strategy by considering the cost structure and value proposition they offered to their customers. Blue ocean strategies will be further discussed in [Chapter 9](#).

1.6 The strategic management process

[Section 1.4](#) mentions that strategic management consists of a series of decisions about the organisation's strategic direction, strategic planning and strategy implementation, supported by **strategic decision making**, **strategic leadership** and **strategic risk management**.

The next section discusses each aspect of the strategic management process, as illustrated in [Figure 1.6](#). While [Figure 1.6](#) depicts the strategic management framework for this text – reflected by the order in which the chapters are arranged – it is important to bear in mind that the strategic management process involves the inherent strategic thinking that underpins the content of each chapter. The strategic management framework, based on [Figure 1.6](#), appears at the beginning of each part of this text as a mind map with the relevant chapters highlighted.

Even though the strategic management framework in [Figure 1.6](#) is presented in linear form, depicting a prescriptive strategic nature, the emergent (descriptive) nature and practice of strategy is considered to be an essential ingredient to successful strategic management. Consequently, strategy formulation and implementation are concerned with both the prescriptive (rational and logical) and emergent (intuitive, creative, experiential and emotional) approaches to strategy, i.e. a combination of Mintzberg's five Ps of strategy. In most instances, the strategy an organisation follows will be a mixture between 'deliberateness' and 'emergence'. In the strategic management process as shown in [Figure 1.6](#), strategic planning (strategic direction and analysis, strategy development) and strategy implementation takes place within an organisation's strategic context. In turn strategic planning and implementation is supported by **strategic decision-making**, strategic leadership and strategic risk management.

1.6.1 Strategic direction

The strategic management process outlined in this text is grounded in setting the strategic direction for the organisation. This includes understanding the purpose and context of the organisation – key elements of a sustainable organisation ([Chapter 2](#)), and the importance of strategic direction ([Chapter 3](#)).

In [Chapter 2](#) we discuss the organisational purpose and context as vital elements of strategy and a sustainable organisation. Strategy design and implementation are influenced by understanding the purpose of an organisation and the changing context in which it operates. Within the changing context, we argue that in strategising it is important to focus on value creation for an array of stakeholders rather than only on the shareholders. This includes identifying and responding to diverse risks and opportunities that arise from the changing context, recognising the potential for turning social problems into business opportunities – key elements of a sustainable organisation. The chapter ends with an overview on integrated reporting as a means of transparently communicating on progress, and this in turn should help managers improve their strategies.

Strategic direction, discussed in [Chapter 3](#), is essentially concerned with the direction in which an organisation wants to advance, the type of organisation it aspires to be, and how it proposes to achieve this direction. When an organisation persistently pursues its strategic vision, mission and goals, and focuses all its resources and competitive actions on achieving them, then it demonstrates strategic direction. In this chapter, the strategic tools organisations employ to set their strategic direction are explained. These include [strategic intent](#), [vision statements](#), [mission statements](#), value statements and balanced scorecards.

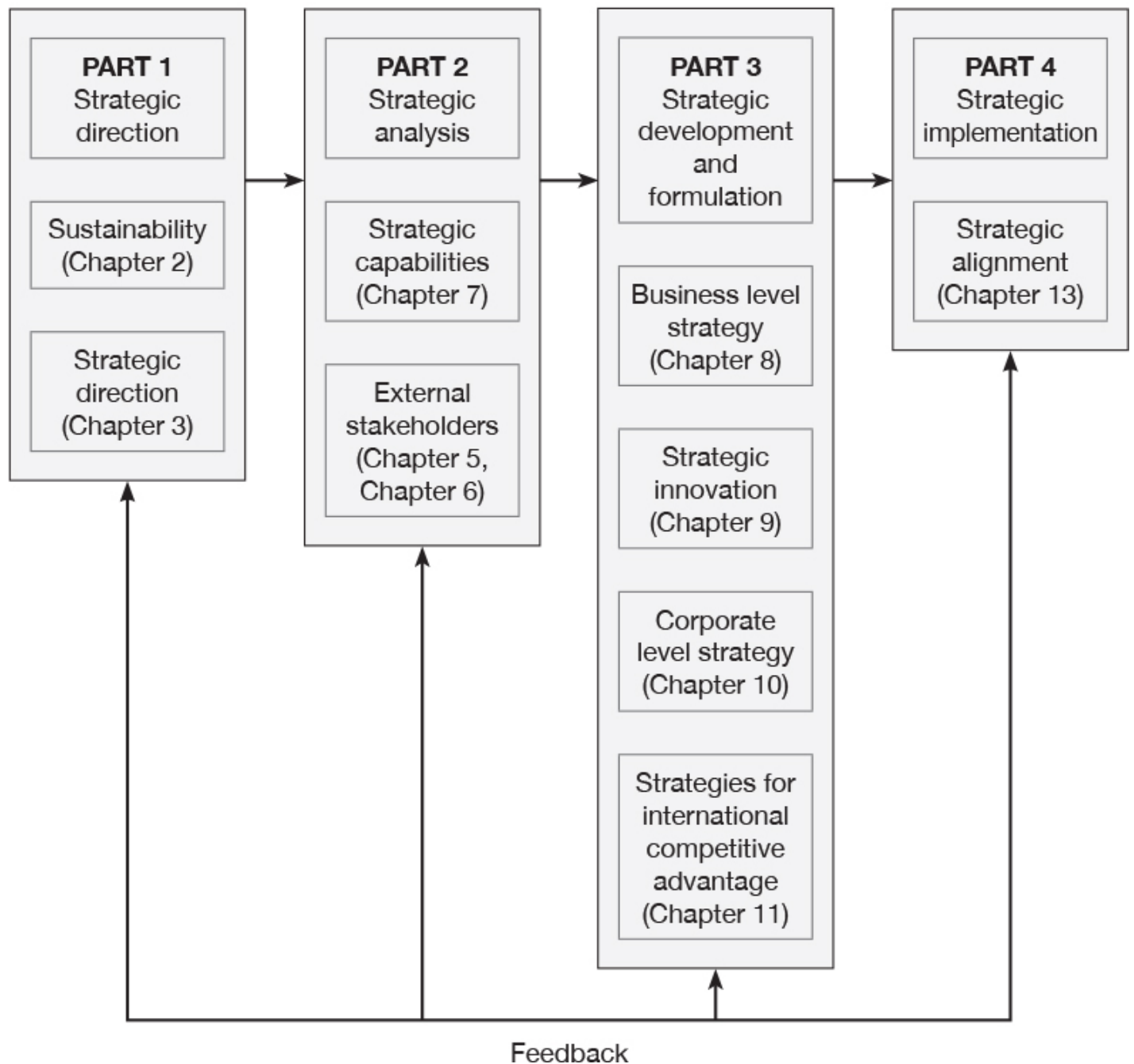
Figure 1.6 Strategic management framework

THE ORGANISATION'S STRATEGIC CONTEXT

Strategic decision-making
(Chapter 4)

Strategic leadership
(Chapter 12)

Strategic risk management
(Chapter 14)



Considering what it means to be a sustainable organisation, strategic direction normally signifies the beginning of the direction-setting stage in the strategic management process, as the organisation poses the question: 'What do we really want to become?' At times, it is necessary to refer back to the strategic direction after extensive strategic analysis has been conducted. The next section introduces strategic analysis.

1.6.2 Strategic analysis

While most texts emphasise the importance of external and internal environmental analysis in supporting strategic decision-making, few recognise the importance of having an integrating mechanism and a complex infrastructure in place to support strategic decision-making. In [Chapter 4](#) we examine strategic decision-making as a complex activity that differs from organisation to organisation. Various approaches to strategic decision-making and the many contextual influences on it are discussed. It is argued that effective strategic decision-making is supported by a complex network of people, processes and technology that process intelligence and present it in a form that adds value to and supports management decision-making. The chapter also highlights how managers can use simple approaches such as stimulating conflict and developing collective intuition to improve decision-making speed and efficiency in organisations.

Facilitated by strategic decision-making, the organisation analyses its environments in order to address the question: 'What is our current situation?' Strategic analysis consists of analysing and evaluating the strategic link between the opportunities and threats in the external environment of the organisation (outside-in perspective) and its internal strengths and weaknesses (inside-out perspective). In [Chapter 5](#) the importance of the external environment (political-legal, economic, sociocultural, demographic is, technological and natural environment is evaluated while the industry environment is discussed in [Chapter 6](#).

The **internal environment** refers to the organisation's strategic ability to innovate as determined by its resources and capabilities (inside-out perspective) when creating customer value and building a competitive advantage. According to the inside-out perspective, an organisation should design and develop its strategies around its resources, and distinctive and dynamic capabilities to take advantage of the opportunities in the external environment (see [Chapter 7](#)).

1.6.3 Strategy development and formulation

After an organisation has set its strategic direction and external and internal environments, facilitated by strategic decision-making, strategic leadership and strategic risk management, it needs to develop and formulate its strategies. The organisation now needs to answer the key question: 'Where are we going?'

The organisation must first develop and formulate business level strategies. [Chapter 8](#) discusses business level strategy concerns when an organisation plans to compete successfully. Strategies at business level are often referred to as competitive strategies because they relate to the organisation's deliberate decisions on how to:

- Meet customers' needs
- Counter the competitive efforts of competitors or rivals
- Cope with existing market conditions
- Sustain or build competitive advantage in a single line of business.

The development and formulation of **corporate level strategies** are based on the decision to move an organisation into more than one line of business, nationally or internationally, and an understanding of the underlying strategic value innovation options. [Chapter 9](#) discusses strategic innovation, which essentially offers existing buyers in existing markets significantly greater net value than they are currently receiving, or offers fundamentally new and significant net value for buyers that results in the creation of new markets. In creating new and significant net value

for buyers, organisations have to consider gaining a competitive advantage by operating in several businesses simultaneously beyond their business level strategies. Blue ocean strategies and the opportunities for innovation, the role of leadership as a contributor towards organisational innovativeness and individual innovativeness within an organisation are also dealt with in this chapter.

Operating in several businesses simultaneously means that organisations need to develop and formulate corporate level strategies (discussed in [Chapter 10](#)), and strategies for attaining a global competitive advantage. [Chapter 11](#) discusses strategies for global competitive advantage, and focuses on examining the motives for internationalisation, and the strategic options available to organisations that intend to expand their business to foreign markets. [Chapters 8 to 11](#) discuss strategic choices in strategy development and formulation. These choices are guided by the organisational purpose, context and strategic direction of an organisation.

1.6.4 Strategic implementation

Once an organisation developed and formulated its strategies, the next step is to implement them. Successful strategy implementation is dependent on strategic leadership (the key driver of implementation), sound organisational architecture, and sound organisational alignment with its architecture, and strategic risk management. In successfully implementing its strategy, the organisation needs to consider how its leadership and organisational architecture enable a response to the question of: ‘How will we get there?’ while its strategic performance and control addresses the question of ‘How are we doing?’

As mentioned previously, even though strategic leadership is associated with strategy implementation, in this text while strategic leadership supports the strategic planning process, it is integral in implementing strategy successfully.

[Chapter 12](#) addresses leadership by considering the responsibilities of effective strategic leaders who are responsible for understanding the organisation as a whole, leading effectively and ethically, developing and communicating a compelling vision to lead change, creating an organisational system supportive of the strategy, building and using distinctive organisational capabilities aligned to the strategy, ensuring ethical practices and good governance, and initiating and managing change. [Chapter 13](#) focuses on organisational alignment and how an organisation implements its strategies through its organisational architecture, i.e. processes and routines, structures and systems, KSAs (knowledge, skills and abilities), technology and organisational culture, to create a sustainable competitive advantage by adding value. [Chapter 14](#) discusses **strategic risk management** and its role in effective strategic management, the risk management process, the impact of risk on strategy, the monitoring of risk and finally how risk performance management could be improved.

Even though strategic risk management is integral to strategy implementation, in this text strategic risk management also supports strategic planning.

1.7 Tests for a winning strategy

There are three tests for assessing the effectiveness of an organisation’s strategy:¹¹⁰

- *Goodness of fit test*: How well does the strategy fit the organisation’s situation? To be a sustainable organisation, there has to be a conceptual fit or strategic link between the internal and external environments. The organisation can achieve this link by an inside-out (strategic stretch) or outside-in (strategic fit) perspective (discussed in [section 1.5](#)).
- *Competitive advantage test*: Is strategy helping the organisation achieve a competitive advantage? The larger the competitive edge over rivals is, the more sustainable the competitive advantage will be.
- *Performance test*: Is strategy resulting in above-average organisational performance by adding value? Indicators include financial strength and above-average profit gains, and an increase in competitive strength and market

standing.

In the context of developing countries with emerging markets, the triple bottom line (economic, social and environmental) impact of strategy is critical. Consequently, two additional tests are relevant in developing countries, namely:

- *Social impact test*: Is strategy contributing towards the expectations of stakeholders? In developing countries, an organisation's strategy contributes towards overall poverty alleviation and the well-being of citizens. In South Africa, working closely with the political environment regarding aspects such as Broad-Based Black Economic Empowerment, social responsibility, and HIV/Aids to improve social stability would contribute towards a sustainable organisation. One of the dilemmas of strategic management is balancing social entrepreneurship with the demands of global competitiveness.
- *Environmental system test*: Is strategy contributing towards the protection and sustainability of natural resources and the ecological system? Globalisation has stimulated growth in developing countries, along with the familiar 'pattern of suburban sprawl, pollution, loss of habitat and competition for natural resources'.¹¹¹ Sustainable organisations meet the needs of current generations while protecting the sustainability of natural resources and the ecosystem.

A winning strategy has the following characteristics:

- There is a strategic link between the organisation's internal and external environments.
- It builds a competitive advantage.
- It improves organisational performance.
- It meets the expectations of stakeholders.
- It aligns itself with socio-environmental requirements in a global context.
- It requires strategic feedback and monitoring.

1.8 Strategic paradoxes

This chapter referred to the dynamic nature of strategy, how this relates to decision-making, and its impact on strategic effectiveness. However, in managing strategically, leaders are often confronted with paradoxical situations. A **paradoxical situation** is defined as having 'two opposite facts, or qualities, which you would think could not both exist at the same time'.¹¹² The next section explains the main strategic paradoxes¹¹³ referred to in this chapter. They illustrate the complexity of the nature of strategy.

1.8.1 Paradox 1: Past and future

The challenge for strategic leaders is to balance the past with the future. Organisations learn from their past successes and failures. Often, strategy development and formulation is based on the past with continuous improvements around the same competitive paradigm. Organisations make incremental changes to their current strategies.

At times, however, a more dramatic and discontinuous change means that an organisation should abandon the past and current competitive paradigms in pursuit of a strategy to meet future demands. As is evident from this example, strategic leaders should be careful of perpetuating the paradigms of the past. They must consider the cost of making unnecessary disruptive changes to adapt to current and future environmental demands. Strategic leaders need the wisdom to know when, and how much, change is required to manage the paradox between past and future.

1.8.2 Paradox 2: Intended and emergent strategy

While adopting a rational approach to strategic planning is critical to accomplishing intended strategies, the intuitive insights of leaders responding to the dynamic competitive environment are necessary for strategy development. The challenge for leaders is to maintain a sense of balance and flexibility in striving to attain intended strategies while allowing for emergent strategies. Leaders should use their strategic decision enablers so as to be finely attuned to the developments and unpredicted changes in the external or internal organisational environments. In this way, they will be more open to accepting valuable emerging strategies that they could overlook because of their focus on intended strategies. At Nokia, the change in technological advancement and the complexity of market changes soon rendered their intended strategies ineffective. In an attempt to have a more relevant business model, Nokia introduced the New Ventures Organisation (NVO) in 1995 – a new growth area. Despite the NVO being ahead of its time as they correctly identified ‘the internet of things and found opportunities in the multi-media health management, it failed due to an inherent contradiction between the long-term nature of its activities and the short-term performance requirements imposed on it.’¹¹⁴ Leadership was not able to fully implement its intended longer-term strategies as it was ‘too absorbed with managing growth in existing areas to focus on finding new growth.’¹¹⁵

1.8.3 Paradox 3: Reactive or proactive approach to strategy

At times, strategic leaders will need to lead the change agenda with deliberate strategies while at other times they should be able to respond to unexpected events by using emergent strategies. Strategic leaders should be attentive to the process of managing emergent strategies and think strategically about the ‘worth of emergent strategies’. In other words, which of these strategies should be relinquished or implemented based on whether it ‘fits the company’s needs and capabilities’, of which organisational culture is critical to successful strategy implementation.¹¹⁶ Whether strategies are deliberate, emergent or a combination of both, strategic leaders’ approaches could either be proactive or reactive in nature. In turn, a combination of being proactive and reactive to unexpected changes can also take place.

The principle of being proactive in their strategic approach is highlighted in the Strategy in action case study of AutoTrader. Even though South Africa was not quite ready for the internet in 2007, the leadership at AutoTrader proactively decided to change their business model from print to digital platforms. Little did they realise that the scope of the digital platforms would be so much (20%) larger than their magazine sales. Despite their success in the print business, AutoTrader South Africa made the decision to be proactive and to be an industry leader ahead of the innovation curve. In doing so, they positioned themselves for sustained growth in the ‘digital market of buying and selling cars.’¹¹⁷ On the other hand, the leadership of Kodak responded reactively to changes in the external and competitive environment by waiting too long before they transformed into a digital imaging organisation. Instead they continued to focus on making photography available to the masses. Despite their attempts to transform the organisation, they went bankrupt in February 2012. Kodak, has since then ‘emerged from bankruptcy, having shed many of the businesses that made it famous’. Their focus has shifted to selling printing equipment and services.¹¹⁸

1.8.4 Paradox 4: Inside-out or outside-in driven strategies

Section 1.5 discussed this point and highlighted that there needs to be a balance between the inside-out and outside-in perspectives when managing strategically. The challenge that needs to be resolved is which one of these perspectives should be prioritised. In the case of Nintendo, a Japanese multinational, the company was able to introduce a new product using its internal resources and dynamic capabilities. For example, in 2018 Nintendo introduced the new ‘Switch accessories dubbed Nintendo Labo – a range of build-your-own cardboard kits that can transform the Switch’s controllers into anything from a keyboard to motorbike handles ... [T]hese cardboard

devices add a creative and educational dimension making the Switch more appealing to younger children.’¹¹⁹ To learn more about their inside-out blue ocean strategy, view the video clips on <https://labo.nintendo.com/>

In the Strategy in action case study on AutoTrader, we see that in response to the external environment the organisation was able to position itself for sustained growth in the digital market of buying and selling cars – an outside-in strategic approach.

1.8.5 Paradox 5: Profitability versus sustainability

As already mentioned, all organisations, whatever their size, format or stage of development, require strategies to achieve their purpose. The main strategy for profit-seeking organisations is to maximise the return on their investment, thereby maximising profitability. Profitability is the ability of an organisation to generate net income on a consistent basis, often measured by the price-to-earnings ratio. The perspective taken in this text is that a competitive advantage with above-average returns (maximising profitability) is enhanced by creating value, managing ethically, and being a sustainable organisation. Sustainability and strategy are inseparable. A profit-seeking organisation that is sustainable, in addition to seeking a profit, maintains and enhances its environmental, social and economic obligations to meet the needs of current and future generations. Such organisations integrate corporate social responsibility, stakeholder claims and corporate citizenship into their strategic planning and implementation. The challenge for strategic leaders is to bear in mind that profitability and sustainability are not mutually exclusive. Focusing on profitability alone is a short-term orientation, while broadening the focus to include sustainability is a longer-term, more beneficial orientation.

1.9 Summary

As globalisation and technological innovation drives the 21st century competitive landscape, the challenge in managing strategically is to achieve strategic competitiveness while being sustainable in the global environment. The perspective of this text is that an organisation can achieve strategic competitiveness by formulating and implementing value-creating strategies while following the principles of sustainability. When an organisation implements value-creating strategies that competitors are unable to duplicate, or that are too costly to imitate, it has achieved a competitive advantage. Strategy is the manner in which (how) the organisation competes to deliver unique value. Only when strategy is grounded in a competitive advantage will it contribute towards above-average returns by offering value to customers. This implies that the organisation has resources and dynamic capabilities in different areas of operation that add value to how it responds to external opportunities and challenges in a dynamic and uncertain environment, while being a valued corporate global citizen. Attaining the strategic link between the internal (inside-out) and external (outside-in) organisational environments is fundamental to achieving strategic competitiveness and above-average returns, and enhancing long-term sustainability.

This chapter discussed the nature of strategic management. In presenting the nature of strategy, aspects discussed included the essence of strategy, historical context and strategy development, the nature and role of strategy, levels of strategy, perspectives on managing strategically, the strategic management process, the tests of a winning strategy, and strategic paradoxes. This chapter explained why applying the principles of strategic management is important in establishing a competitive advantage, and highlighted the importance of being a sustainable organisation. The framework representing the chapters in this text is depicted in [Figure 1.6](#).

REFLECTION BOX:

Consider the changes in the world from 2020 to 2050. Identify what you think would be the main drivers of strategy during this period. Reflect on your opinion as to how these drivers will influence the strategic

imperatives faced by organisations, including the changes in the workplace.

Hint: Refer to the following video clip to stimulate your reflection: The world 2020–2050
<http://www.youtube.com/watch?v=rU2iTUeCfkl> [Accessed 30 January 2018]

Opening case study questions

1. Advise the CEO at Shoprite Holdings Ltd on the strategic management process.
2. Identify and discuss the implications of the new strategic direction of Checkers in catering for the more upmarket consumers.
3. Comment on what Shoprite Holdings Ltd do to ensure that their business is conducted holistically and operates in a responsible, ethical and sustainable manner in creating value for their customers. Provide examples in your response.
4. Refer to Shoprite Holdings Ltd's sustainability report. Discuss the importance of the 'six capitals' and provide examples of how they intended to create value in each capital.

Discussion questions

1. Explain the concept of strategy in your own words, and briefly explain the five Ps of strategy.
2. Distinguish between intended, deliberate, emergent and realised strategy.
3. Discuss the roles of different management levels in strategic management. In your opinion, what would be an important consideration, given the challenges of the 21st century competitive landscape?
4. Explain competitive advantage, above-average returns and value-creating capabilities. Why are these concepts important for an organisation's performance?
5. Distinguish between the inside-out and outside-in perspectives in analysing strategy.
6. Explain what is meant by strategic management, and discuss the dynamic nature of the strategic management process.
7. Critically evaluate the merits of each of the tests of a winning strategy.
8. Advise top management on how the strategic paradoxes would affect their strategic effectiveness.

Using knowledge and skills

1. Select two organisations in South Africa in different industries that you consider the best to work for and visit their websites. You are required to identify:
 - a) the vision and mission statements for each organisation
 - b) their customer value propositions
 - c) how they endeavour to achieve a competitive advantage
 - d) the main strategies pursued by each organisation
 - e) how each organisation manages the conceptual fit between its internal (inside-out perspective) and external environments (outside-in perspective)
 - f) at least one strategic paradox for each of the organisations.
2. Read the following article on what went wrong with Kodak:
Usborne, D. 2012. The moment it all went wrong for Kodak. *Independent*, 20 January. [Online]. Available:
<https://www.independent.co.uk/news/business/analysis-and-features/the-moment-it-all-went-wrong-for-kodak->

6292212 [Accessed 4 February 2018].

Using the outside-in perspective of strategy, in your opinion, outline what went wrong with Kodak and explain how they tried to reposition themselves between 1993 and 2012. You can also follow the commentary on <http://6report.com/2012/02/03/the-scale-of-Kodaks-rise-and-fall/> to assist you in your response to the question posed.

3. Learn more about Woolworths Holdings' sustainable strategy by visiting their website: <http://www.woolworthsholdings.co.za/corporate/sustainability.asp> [Accessed 30 January 2018]. Access the *Good News Business Journey 2017 Report*. You are required to:
 - a) comment on their sustainability indicators and recognition
 - b) comment on their stakeholder engagement programme
 - c) provide a critical review on the chief executive and chairman's reports. Were you able to identify their value propositions in these reports?
4. Refer to the following video clip entitled 'African business landscape with Scenario Planner Clem Sunter': <http://www.youtube.com/watch?v=zU-nBXSjwOw> [Accessed 30 January 2018].

Prepare a brief overview on your opinion on where Africa will find itself in the year 2040, and identify the main external drivers of strategy that organisations would have to consider in their strategic planning.
5. To learn more about Nintendo, a Japanese multinational's strategy, view the video clips on <https://labo.nintendo.com/>. Comment on how Nintendo used the inside-out blue ocean strategy to redefine its value proposition to further sustain its current competitive advantage.

Further reading

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Suggested websites

- African business landscape with Scenario Planner Clem Sunter (<http://www.youtube.com/watch?v=zU-nBXSjwOw>) [Accessed 30 January 2018].
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- Global Reporting Initiative (www.globalreporting.org) – A network-based organisation that has pioneered the development of the world's most widely-used sustainability reporting framework and is committed to its continuous improvement and application worldwide. [Accessed 30 January 2018].
- Global Awareness with Google Earth (<http://www.youtube.com/watch?v=3sVgxxIETxU>).
- iisd2018 (www.iisd.org/sd) – What is sustainable development? Iisd 2018 is a Canadian-based policy research institute that has a long history of conducting cutting-edge research into sustainable development. [Accessed 30 January 2018].
- Rocky Mountain Institute (www.rmi.org) – An independent, entrepreneurial non-profit think-and-do tank that drives the efficient and restorative use of resources.
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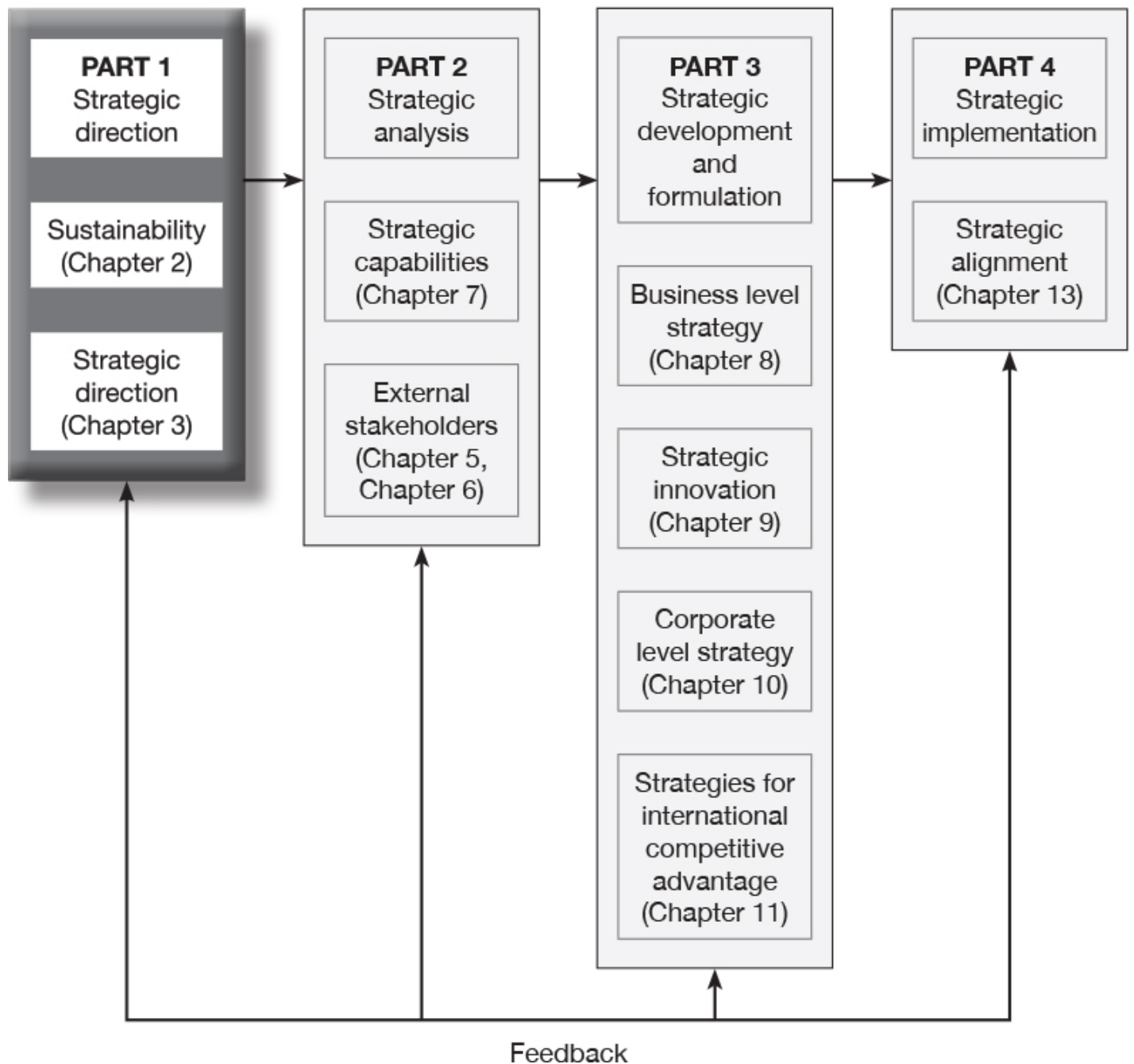
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THE ORGANISATION'S STRATEGIC CONTEXT

Strategic
decision-
making
(Chapter 4)

Strategic
leadership
(Chapter 12)

Strategic risk
management
(Chapter 14)



CHAPTER 2

The purpose and context of business: Key elements of sustainable organisation

Ralph Hamann

LEARNING OUTCOMES

After reading this chapter, you should be able to:

- recognise the crucial role of defining an organisation's purpose in making and implementing strategy
- recognise the implications of both short- and long-term strategic thinking for the creation of a sustainable organisation
- consider a shift from focusing only on shareholders to focusing on a broader array of stakeholders in strategy-making, and recognise the varying salience of different stakeholders
- analyse important social-ecological trends in an organisation's context and the corresponding risks
- identify the organisational opportunities associated with creating shared value and developing inclusive business models
- understand how an organisation's context can be embedded in its strategy
- consider how to approach monitoring and reporting on embedding purpose and context in strategy implementation

KEY TERMS

context-based strategy-making

integrated reporting

organisational purpose

shared value

social-ecological context

social-ecological risks

stakeholders

strategic timeframe

OPENING CASE STUDY



Patagonia

It could be argued that Patagonia started in 1957 when its founder, Yvon Chouinard, developed and sold climbing equipment from the boot of his car. By 2015, the outdoor clothing and equipment company received revenues of over USD 600 million and had over 2 000 employees. But it is best known for its unusually strong commitment to environmental issues. This commitment can be traced back to Chouinard's original motivation. He was a passionate climber and the first products that he developed were climbing implements that were reusable or that did not damage the rocks when climbers clambered up.

This commitment has been retained throughout the last 50 years, as is evident in the company's mission, which is prominent on its website: 'Build the best product, cause no unnecessary harm, use business to inspire and implement solutions to the environmental crisis.'

The website goes on to illuminate the company's reason for being: 'Patagonia grew out of a small company that made tools for climbers. Alpinism remains at the heart of a worldwide business that still makes clothes for climbing – as well as for skiing, snowboarding, surfing, fly fishing, paddling and trail running. These are all silent sports. None require a motor; none deliver the cheers of a crowd. In each sport, reward comes in the form of hard-won grace and moments of connection between us and nature.'

Our values reflect those of a business started by a band of climbers and surfers, and the minimalist style they promoted. The approach we take towards product design demonstrates a bias for simplicity and utility.

For us at Patagonia, a love of wild and beautiful places demands participation in the fight to save them, and to help reverse the steep decline in the overall environmental health of our planet. We donate our time, services and at least 1% of our sales to hundreds of grassroots environmental groups all over the world who work to help reverse the tide.

We know that our business activity – from lighting stores to dyeing shirts – creates pollution as a by-product. So, we work steadily to reduce those harms. We use recycled polyester in many of our clothes and only organic, rather than pesticide-intensive, cotton.

Staying true to our core values during thirty-plus years in business has helped us create a company we're proud to run and work for. And our focus on making the best products possible has brought us success in the marketplace.'

The mission has influenced the company's strategies and decisions. For instance, as mentioned above, the company committed itself to using organic cotton to reduce the negative environmental impact of the agricultural production of the raw materials used in clothing. This was not as easy as it may sound, because the company couldn't just switch suppliers but had to develop them first. There have also been other challenges. In particular, it has not been easy for Patagonia to live up to the promise of offering the 'best products' – which often rely on chemicals to make them water resistant, for instance – at the same time as behaving in an environmentally friendly way.

Patagonia's mission has also featured prominently in its branding and marketing strategy. One of the most famous instances of this was its marketing campaign launched in 2011, which encouraged consumers to buy less of its products. It included a full-page advert in a national US newspaper that showed one of the company's most popular jackets under the caption, 'Don't buy this jacket'. It added, 'The environmental cost of everything we make is astonishing.' Two years later, Patagonia introduced its 'Better than new' initiative that allowed customers to trade in their used goods, which the company resold or recycled. It may seem paradoxical, but in the years following the 'buy less' campaign the company's sales increased significantly. The company has continued to grow – both as a business and as a staunch public campaigner on social and ecological issues. The current CEO Rose Marcario is taking the company's activism even further to directly oppose what she considers unhelpful government policy in the United States.

Sources:

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Overview

This chapter focuses on two key aspects of business strategy: purpose and context. If strategy is about defining and achieving organisational objectives, then it is important to be clear about the underlying purpose of the organisation. Furthermore, an organisation's purpose will need to be defined and realised in a way that responds not only to the market but also to the organisation's social and ecological context, which is continuously changing. This context provides both opportunities and risks that need to be addressed in the creation and implementation of strategy.

In this chapter, we will first consider what we mean by **organisational purpose** and why it is important. Organisational purpose refers to the fundamental reason and motivation for the organisation's existence. It may be explicit or implicit, and often it is both. It is the single most important, overarching objective of the organisation, which determines the various other, subsidiary objectives that may be identified. We then discuss the role of different **strategic timeframes** in strategy-making, and whose interests managers need to consider in this process. Strategic timeframes refer to the period of time that is prioritised when making strategic decisions, such as investment decisions. This includes in particular the period of time that is prioritised when considering financial returns from such investments. Next, we focus more specifically on companies' dynamic **social-ecological context** and how to analyse salient trends, recognising both the risks and opportunities associated with this context. The social-ecological context of an organisation refers to the social and ecological systems, and their interrelationships, on which an organisation depends. Finally, we discuss ways of effectively embedding both purpose and context in strategy, including ongoing monitoring and reporting on progress.

2.1 Introduction

Consider the Opening case study. Patagonia is one of the best known companies globally that has not only emphasised a purpose- and context-driven approach to strategy, but has also reaped significant benefits from this approach. Note how the company speaks about its origins and purpose. Rather than emphasise profits and shareholder returns, the focus is on a love for nature and for nature-based and adventurous activities. The case study also speaks of the company's commitment to not only provide environmentally friendly products, but also to 'fight to protect' nature. This is clearly not your usual corporate mission statement! It often sounds more like an environmental activist organisation. Nevertheless, Patagonia's purpose and its explicit stance on its social and ecological context have not constrained its financial fortunes – instead, the company has steadily grown its customer base and earnings.

To what extent do you think this case study offers guidance and inspiration for organisational strategy, more generally? On the one hand, you might see Patagonia as an unusual oddity, reaping the benefits of the niche expectations of a particular segment of the market. On the other, Patagonia may be seen as just a particularly pronounced expression of a broader trend, as companies in diverse sectors seek to create a more harmonious relationship with the social and ecological systems, on which their value chains depend. This trend is arguably especially visible among consumer-facing businesses, such as Woolworths in South Africa, which has gained international acclaim for its 'Good Business Journey' strategy (to which we will return later in the chapter). But it is also apparent in other companies and in other sectors, for a variety of reasons. For example, mining companies are giving increasing attention to enhancing their relationships with surrounding communities, because they have learnt that community and labour protests can stifle their operations, and because governments and investors also demand that they emphasise a diligent and responsible approach to social and environmental matters.

Diverse organisations in diverse sectors are thus learning to give more careful attention to their purpose and their social-ecological context. These are the two important aspects of organisational strategy that we focus on in this chapter.

2.2 Purpose

An organisation is a group of people that commit to working together to achieve certain objectives. However, these objectives can be diverse and sometimes even at odds with each other. Strategy is about prioritising and aligning objectives. To do this, it is important to think deeply and continuously about the organisation's underlying purpose. The purpose is the fundamental reason for the organisation's existence. You could say that the purpose is the single most important, overarching objective of the organisation, which determines other objectives that you might identify. These other objectives are the means to fulfil the purpose.

Strangely enough, however, we do not often stop to think or talk about an organisation's purpose. This is also because we often assume that everyone knows and agrees what the purpose is. For businesses, we often assume that the key purpose is to make money. But is profit the purpose of a business or the outcome of achieving its purpose? Whose profit or benefit are we concerned about – is it only the owners and investors, or also other stakeholders? What time frame are we aiming for – is the profit to be achieved in the short-term, or are we aiming for long-term returns? There are not always right or wrong answers to these questions, but it is important to keep asking them.

The idea that businesses exist primarily to make money for investors has not always been so dominant. One of the reasons it has become prevalent is the work of an influential economist, Milton Friedman.

In 1970 he argued that asking managers to address social causes is misguided for at least two reasons. First, managers do not have a mandate from shareholders to do so. From this perspective, shareholders expect financial returns and do not want managers to do anything that will compromise such returns. Second, he argued that managers are not trained or well equipped to address social issues, so such issues should be left to governments and civil society organisations.¹

What do you think – do you agree or disagree with Friedman's argument?

One of the challenges in answering this question is that Friedman's argument might be interpreted in different ways. Unfortunately, in my view, many scholars and managers have interpreted his argument to justify a single-minded focus on profits with little regard for the possible social and environmental costs – such as pollution – that are generated by this pursuit of profits. Economists call such social and environmental costs externalities.

One of the problems with such a narrow interpretation of Friedman's argument is that it assumes that the law is effective and sufficient in avoiding such social and environmental costs. But we know that the law is often too limited or governments are too constrained in effectively implementing it.

As a result, managers have been incentivised to increase profits by reducing costs associated with taking care of people and the environment. For instance, a manager may be faced with the decision to invest in a new, cleaner production system in order to reduce water pollution of a nearby river. But this investment will reduce profits and because there is little enforcement of pollution laws, the manager will be motivated to avoid this investment and continue polluting the river.

On the other hand, it may be argued that polluting the river will create negative consequences for the business and so the manager may be motivated to reduce pollution for other reasons. For instance, many of the organisation's employees might be living on the banks of the river, in communities reliant on fishing. If these communities suffer, the organisation may suffer due to decreased employee productivity. Or people may complain about the pollution, stage protests, or even sabotage the operation. It is possible to argue that Friedman recognised such possibilities when he referred to the 'interests of the corporation'. In fact, elsewhere in that article he argued that an organisation that employees many people within a small community would benefit in the long run if it provides services and facilities to this community and has a focus on improving its management. This would make the organisation attractive to potential employees and help to draw the best talent.

This emphasis on the long-run benefit to a corporation is related to what is sometimes referred to as an 'enlightened shareholder perspective'. In other words, a manager's responsibility is to ensure profits for investors, but to do so for the long-term in a way that ensures the continued viability of the organisation. Taking good care of

employees and customers, neighbouring communities, and the environment is thus seen as an important aspect of ensuring long-term benefits for shareholders.



This perspective is becoming increasingly prominent. Even in legal terms, the fiduciary responsibility of directors is not defined as maximising shareholder profits, but as acting ‘in good faith and... in the best interests of the company’ (Section 76 in the Companies Act of 2008). Similarly, the King IV Report on Corporate Governance expects directors to act ‘in the best interests of the organisation’² – in other words, they are meant to ensure the ongoing viability and fulfil the purpose of the organisation, not only or specifically to increase the financial rewards for owners.

Prominent business leaders are increasingly expressing their strategic priorities in this kind of way, aiming for a mutually beneficial interaction between their business operations and the social-ecological context. A South African example of a leader of this sort is the former CEO of Woolworths, who described Woolworths’ strategy in terms of its ‘Good Business Journey’.

The following is a statement issued by the Chairperson of the Sustainability Committee of Woolworths, Simon Susman in 2018:

Being a values-based organisation means that doing business responsibly sits at the heart of the Woolworths Group. We are acutely aware of our position in society and the leadership role we can play in driving positive change. The Good Business Journey (GBJ) is our platform from which we action this change in the areas of community development and environmental management. The programme centres around eight focus areas, namely transformation, social development, health and wellness, ethical sourcing, sustainable farming, waste, water, as well as energy and climate change. Now in its 11th year, the drivers behind the GBJ are more relevant than ever before. Global flux and uncertainty across political, social, environmental and climatic spheres requires business to take a stand on what matters. To us, this means addressing the sustainability of our business across the entire value chain, from within our own operations, to our supply chain, customers, and products.

It is with this mind that we launched our ambitious packaging targets this year. Our vision as a Group is to work towards zero packaging waste to landfill... The targets we’ve set ourselves are to phase out single-use shopping bags by 2020 and to work towards making all our packaging reusable or recyclable by 2022.

*A second focus for us this year has been water. With areas of the Western, Eastern, and Northern Cape facing the real possibility of running out of water, we stepped up our long term efforts to build resilience across the business...During the year, we directed almost R815 million across the Group to a range of organisations and projects as part of our commitment to community upliftment through the work of the Woolworths Trust and through donation of our surplus food and clothing.*³

However, it is important to note that even the ‘enlightened shareholder perspective’ still prioritises the purpose of business, as organisations pursuing profits for shareholders, even though it encourages a more careful consideration of the social and ecological context. So, what happens if there is a direct trade-off between social or ecological benefit, on the one hand, and profit – even long-term profit – on the other? Or how do managers act if the relationship is unclear?

Some business leaders have thus identified social and ecological benefits as an intrinsic good, rather than an instrumental value. Intrinsic means that something has value in and of itself; instrumental means that it has value because it helps you achieve something else. Such business leaders define their business purpose with an explicit social and ecological orientation, and they seek to fulfil this purpose even if it is not required by law and even if it does not benefit shareholders. There are not many examples of large organisations with such intrinsic social and ecological purpose – the company in the Opening case study, Patagonia, is a well-known example. But their number is increasing in part because of new laws and policies that enable managers to make social and ecological objectives – and not just economic objectives – an explicit part of their purpose. An example of such an alternative corporate form is the B-Corporation or B-Corp, which is a prominent movement in places like the United States but is also gaining initial traction in South Africa.

2.3 From short- to long-term strategising

The Opening case study and the Case example in the previous section illustrate an emphasis on long-term strategy. The interactions between social, environmental, and business dynamics can play out quickly, but they often involve changes over years. This is the reason why Woolworths’ ‘Good Business Journey’ was designed as a long-term strategy – it was still being implemented in 2018, more than ten years after it was announced, and it was still based on five-year reporting cycles.

The emphasis on long-term strategy cannot be taken for granted. Many investment decisions are made based on the promise of short-term returns. Global financial markets thus put pressure on managers to make strategies that result in profits as soon as possible. Strategies with longer-term benefits, such as Woolworths’ ‘Good Business Journey’, are thus not always easy to design and defend. This is true in many markets. Researchers found that the majority of executives in the USA feel increasingly constrained by a growing short-term focus, especially among investors, and about half of them admitted to avoiding investments even though they would have long-term value-creation benefits.⁴

However, there is growing evidence that a focus on short-term results might actually be bad for an organisation’s economic performance, not to mention its social and environmental impacts. Researchers compared US organisations with longer-term strategic horizons with US organisations that have shorter-term strategic horizons. They found that revenue growth, over a 15-year period, was almost 50% among those organisations with longer-term strategic horizons. They also found that it was possible for leaders to shift the orientation of their companies from a short-term to a long-term strategy, with positive business outcomes.⁵

Indeed, there are numerous well-known business leaders who have argued for more emphasis on long-term strategies and decision-making. One of the best-known examples is Paul Polman, the CEO of Unilever, as described in the Case example below.

CASE EXAMPLE: Paul Polman's focus on the long-term as CEO of Unilever

Paul Polman became CEO of Unilever, one of the world's largest FMCG companies, in 2009 (and retired as CEO end of 2018). From the outset, he emphasised that corporate strategy cannot focus only on short-term gains for shareholders, but that it should focus on creating value for a broader array of stakeholders and that it should adopt a longer-term perspective. The following is an extract from a newspaper article on Mr Polman's strategy at Unilever:

'Mr Polman was determined to change the short-term focus at Unilever: "One of the things I had to do was to move the business to a longer-term plan," he says. "We had become victims of chasing our own tail, cutting our internal spending in capital, R&D, or IT to reach the market expectations. We were developing our brand spends on a quarterly basis and not doing the right things, simply because the business was not performing. We were catering to the shorter-term shareholders." So I said, "We will stop quarterly reporting, and we will stop giving guidance."

When Mr Polman announced Unilever's new policies in 2009, the company's shares dropped 8%. Yet he remained steadfast in his message to shareholders. "I explained to them we were going to run the business for the longer term. We were going to invest in capital spending. We were going to invest in training and development. We were going to invest in new IT systems. And we were going to invest back in our brand spending." These investments would take time to pay off, and they had the potential to skew quarterly numbers dramatically. So Mr Polman asked his shareholders to take a longer-term view, too.

Some shareholders were willing to take the leap with Mr Polman; those who weren't sold their shares, an action that was fine with Mr Polman. Instead of catering to the whims of an established base of short-term shareholders, Mr Polman was focused on getting the shareholder base he wanted – attracting the long-termers who valued growing real returns over inflating expectations. And the policy has worked: Unilever's top fifty shareholders now have an average holding period of seven or more years.'

Sources: <https://www.theglobeandmail.com/report-on-business/careers/management/how-unilever-won-over-shareholders-with-its-long-term-approach/article36538572>; <https://www.forbes.com/sites/danschawbel/2017/11/21/paul-polman-why-todays-leaders-need-to-commit-to-a-purpose/#5df0a2f51276>

Shifting from short-term to long-term thinking is thus an important aspect of more circumspect and purpose-driven strategizing. A second important aspect of such strategizing is a shift from focusing on shareholders to recognising a broader array of **stakeholders**, whose interests need to be considered. You will recall that stakeholders refer to individuals or groups that may affect, or may be affected, by an organisation. This is the topic of our next section.

2.4 From shareholders to stakeholders

Reconsider the CEOs we encountered in the two Case studies above. It is clear that they still recognise their shareholders as very important. After all, their organisations depend on shareholders' money to make investments. But it is also clear that Yvon Chouinard and Rose Marcario (Patagonia founder and current CEO, respectively) and Paul Polman (Unilever CEO) have given a lot of attention to a broader group of stakeholders, or people that are affected by or may affect the strategy and operations of the organisation. In other words, rather than focus strategic attention only on the interests and expectations of shareholders, a stakeholder approach recognises and seeks to respond to the interests and expectations of a broader group of stakeholders, including employees, neighbouring communities, civil society organisations, and so on.

One of the best-known strategy scholars who developed this 'stakeholder' approach to strategy is Ed Freeman. In a recent column co-authored with Heather Elms, he argued that the social responsibility of business is not to increase its profits, but rather 'to create value for stakeholders.'

According to Freeman and Elms, stakeholders are at the core of what enables a company to make profits. Customers buy a company's products or services; employees cooperate and dedicate their time and energy to create these products and services; and suppliers provide important inputs to make all this possible. All of this will probably be constrained if the community living around the company does not see the company as a good neighbour. So, a company can only create value for its owners or shareholders if it also creates value for these various stakeholders; that is, the company's customers, employees, suppliers, and communities. Sometimes there are tensions or trade-offs between these different stakeholders and there is no formula for prioritising stakeholders or balancing their interests. This is an important challenge for managers to address, taking into consideration the specific details of the situation and context.⁶

Similarly, South Africa's King IV Report on Corporate Governance emphasises what it calls 'a stakeholder-inclusive approach', as follows:

*There is an interdependent relationship between the organisation and its stakeholders, and the organisation's ability to create value for itself depends on its ability to create value for others. An organisation becomes attuned to the opportunities and challenges posed by the [social, ecological, and economic] context in which it operates by having regard to the needs, interests and expectations of material stakeholders... A stakeholder-inclusive approach... takes account of the legitimate and reasonable needs, interests and expectations of all material stakeholders in the execution of its duties in the best interests of the organisation over time. By following this approach, instead of prioritising the interests of the providers of financial capital, the governing body gives parity to all sources of value creation, including among others, social and relationship capital as embodied by stakeholders.*⁷

From an enlightened shareholder perspective, there is no contradiction in giving attention to stakeholders. In fact, CEOs like Marcario and Polman would argue that they can only provide long-term, reliable profits for shareholders if they continue to provide benefits to key stakeholders and thus maintain the support of these stakeholders.

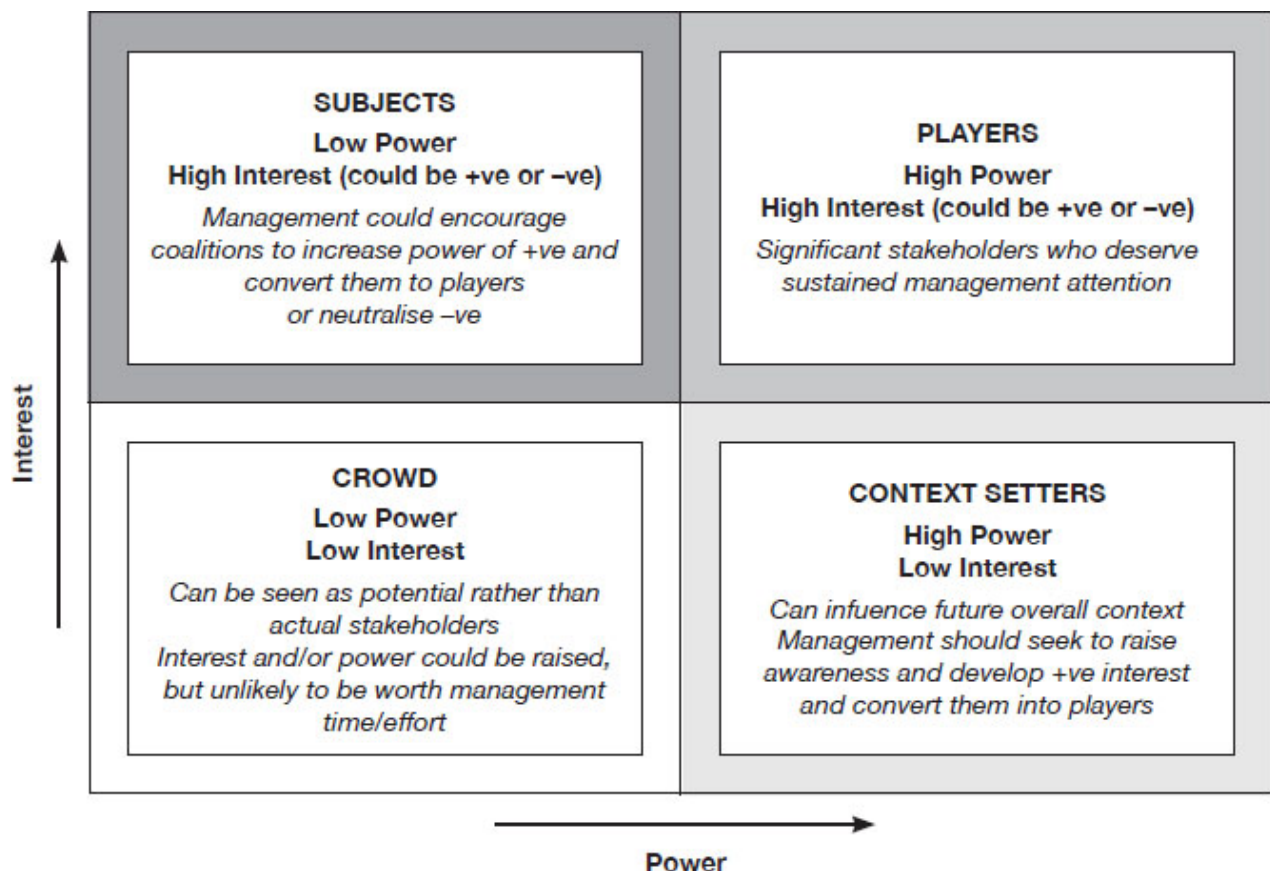
However, it is apparent that any organisation has a large number of diverse stakeholders, some of whom may have different 'stakes' in the organisation. For instance, it is clear that primary stakeholders that have contractual relationships with the company, such as employees, have more direct claims than secondary, more indirect, stakeholders, such as community organisations. But such community organisations can nevertheless become very influential, for instance, by staging protests that obstruct operations. The diversity and complexity of stakeholder relationships becomes greater the larger the organisation becomes. How do managers prioritise such claims and expectations by the various stakeholders of the organisation? There are different ways to respond to this question. The King IV Report on Corporate Governance suggests: 'A decision on how to achieve this balance is made on a case-by-case basis as current circumstances and exigencies require, but should always be done in the best interests of the organisation over the longer term.'⁸

Another response involves a tool that managers use to map stakeholders on two dimensions, namely power and interest. Power refers to the degree to which a stakeholder has influence on the business. For instance, a government agency that regulates the business has a lot of influence; and so do investors, because they can sell their shares and invest elsewhere. On the other hand, community groups that are not well-organised will, most likely, have less power and influence over the organisation. However, it is important to continuously re-evaluate such assessments, for instance, if community groups become more resentful and better organised or networked, their influence may increase rapidly!

The second dimension is stakeholders' interest in the organisation, or in particular initiatives of the organisation. For instance, a community living next to a mine has a greater interest in the mining company than a community living further away. So, if we combine these dimensions, we have four quadrants that may be used to characterise stakeholders and identify corresponding management responses, as illustrated in [Figure 2.1](#):

- Stakeholders that have little interest in, or influence on, the organisation clearly do not require much management attention. Ackerman and Eden refer to these stakeholders as ‘the crowd’⁹. Such stakeholders still need to be monitored, though, because their interest or influence may increase unpredictably.
- Some stakeholders may have high levels of interest in the organisation, but not very much power. Ackerman and Eden refer to these stakeholders as ‘subjects’¹⁰. For instance, there may be a consumer group with a particular interest that is not widely shared by other consumers or stakeholders, and as a result this group will have high levels of interest but not a huge amount of influence. Managers will need to communicate with such stakeholders to understand their concerns and to keep them informed of the organisation’s policies and practices. Managers’ responses will also depend on whether these stakeholders’ views of the business are predominantly positive or negative. If they are positive, managers may want to strengthen their influence by, for instance, helping them establish coalitions with other stakeholders.
- Other stakeholders may not have particularly high levels of interest in the business, but they may have a lot of power. These are referred to as ‘context setters’ in [figure 2.1](#). For instance, a government agency responsible for enforcing relevant regulations has significant influence, but it may pay little attention to your particular organisation because it has so many organisations to regulate. Managers will need to keep such stakeholders satisfied to avoid negative attention.
- Finally, the most important stakeholders are those with high levels of both interest and influence in the organisation, i.e. the ‘players’ in [Figure 2.1](#). For example, labour unions are likely to have high levels of interest because their members work in the organisation and they also have high levels of influence because they can influence workers’ morale and organise strikes. Managers will need to give careful, ongoing attention to such stakeholders.

Figure 2.1: Mapping stakeholders according to interest and power



Source: Ackermann, F., & Eden, C. (2011). *Strategic management of stakeholders: Theory and practice*. *Long Range Planning*, 44(3), 179-196; page 183.

However, as mentioned, the status of particular stakeholders in such an interest-influence map may change very rapidly and unpredictably. It is thus important for managers to give some attention to all stakeholders and to continuously scan the business context to understand trends and possible changes in stakeholders' interests and influence. This is illustrated in the next Case example.

CASE EXAMPLE: Technology companies and the war in the DRC¹¹

Until 2004, a vicious war was fought in the Democratic Republic of Congo (DRC) that involved many other African countries and killed more than 4 million people. Armed conflict has continued sporadically, especially in the eastern parts of the country. Women have been particularly affected because of the use of rape as a weapon of war. In some areas, almost one in two women are victims of sexual violence. But what do rape survivors in the DRC have to do with technology companies such as Apple?

Most managers in such technology companies did not see such women as important stakeholders. They also gave relatively little attention to the NGOs that began, in around 2008, to identify 'conflict minerals' as an underlying cause of the conflict in the DRC. Their argument was that armed militias were controlling the mining of minerals such as titanium and tungsten and were using the income from such mines to fund their violence.

But how is this connected to a company like Apple? Well, Apple's most lucrative business is in manufacturing and selling cellular phones, and these phones contain some of the minerals mined in the DRC. The NGOs thus embarked on a campaign to convince consumers and politicians, especially in the USA, that there is a direct connection between violence to women in the DRC and the cellphones that have become such an integral part of people's lives. As a result, a legislator in the USA argued as follows: 'Without knowing it, tens of millions of people in the United States may be putting money in the pockets of some of the worst human rights violators in the world, simply by using a cellphone or laptop computer.'

However, technology companies resisted this way of framing the problem. Industry representatives argued, 'It is really a security problem and a longstanding ethnic conflict' and not something that can be addressed by technology companies engaging in 'supply chain initiatives.' On the other hand, NGOs realised that technology companies were a powerful mechanism for change and that they could be influenced: 'If Apple is sourcing from a mine filled with human rights abuses, then Apple's reputation suffers. That could lead to a decrease in the stock price.'

Eventually the US government legislated (as part of the Dodd-Frank Act) that all companies had to report publicly on how they are obtaining these kinds of minerals. This information was then used by NGOs to put further pressure on companies to become more proactively involved in avoiding the abuse of mineral mines for funding violence in the DRC. For companies like Apple, this involved working in partnership with these NGOs to identify the best ways to do this. Another prominent technology company, Motorola, explained: 'This is the moment for manufacturers everywhere to be powerful actors for good, to fundamentally change the way minerals are bought.'

2.5 The dynamic business context and evolving risks

The purpose of strategy is to guide managers in making investment decisions. Every investment decision responds to an opportunity, but it also needs to take risk into account. A strategy thus needs to clarify how much risk managers are encouraged to take. It should also highlight the kinds of risks, and the underlying trends that need to be taken into consideration.

This is one of the reasons why managers need to give careful attention to their organisation's context and how it is changing. In fact, the world is changing in rapid ways and this means that the role of context is becoming more and more important for managers. For instance, then-CEO of Woolworths, Simon Susman, argued: 'It is becoming

increasingly obvious to all businesses that sustainable growth can only be achieved through greater attention to the world around us, than has been the case in the past.¹²

Consider for a moment the quote from Milton Friedman, with which we started the chapter. This was written in 1970. What was the world like in 1970, and how has it changed since then?

There are of course many ways to answer this question, but just consider the following:¹³

- There are now about twice as many humans on the planet
- We use about three times as much food and water
- We use about four times as much fossil fuel.

Because of these changes, many scientists argue we have entered a new geological epoch – the Anthropocene – in which humans have a decisive, possibly destabilising impact on the earth as a whole. Scientists furthermore identify nine ‘planetary boundaries’ that define a ‘safe operating space’ for humanity, beyond which the Earth System may become too disrupted for societies to flourish:

- Climate change
- Changes in biosphere integrity (that is, reduced biodiversity and species population sizes)
- Stratospheric ozone depletion (this contributes to the so-called ‘ozone hole’ that increases the intensity and health dangers of the sun’s radiation)
- Atmospheric aerosol loading (this includes air pollution with severe health impacts)
- Ocean acidification (that is, changes in the acidity of the ocean due to, among other things, increased CO₂ in the water, with diverse negative impacts on ocean life)
- Biogeochemical flows (this involves eutrophication due to too much phosphorus and nitrogen)
- Land-system change (especially deforestation)
- Freshwater use (that is, its over-use and pollution)
- Introduction of novel entities (new or modified substances or life-forms that could have undesired effects).

Of these nine boundaries, the first two – climate change and biosphere integrity – have a special status because of their Earth System-wide nature and their influence on all the other boundaries. Significantly, one of these – biosphere integrity – has been impacted well beyond the safe operating space.¹⁴ This is relevant for organisations because of their reliance on ecosystems for resources such as fresh air and water – often without even realising it until it is too late. Ecosystems provide vital goods and services to all social and environmental activities.

- They provide natural resources, including renewable resources such as fish, fertile soils, or timber, as well as non-renewable resources such as minerals and metals. Even though natural systems normally replenish renewable resources, such as fish stocks, the rate at which we are exploiting such resources often means that they cannot renew themselves. For instance, scientists estimate that 90% of the world’s fish stocks are overfished, which means that we are taking out fish faster than they can be replenished. At a certain point, fish stocks will collapse completely and be unable to recover; this has already happened for certain species, in some parts of the ocean.¹⁵
- They provide important processes and cycles. For instance, the way that sediment moves along the shore and becomes trapped by mangroves or other plants plays a crucial role in buffering the coast from storm floods. The floods in New Orleans in 2005 were more severe because many of the natural flood defences had been diminished by inappropriate land and property development. Another important natural cycle involves the movement of nitrogen and phosphorus through water catchments and in soils. They play a vital role as nutrients for plants, but because we are putting too much nitrogen and phosphorus into soils and rivers – mostly due to fertilizing on farms – ecosystems are becoming eutrophied, which means they have too many nutrients. This results in algal blooms that kill off other species.
- Finally, ecosystems provide important sinks for our wastes. Economic activity creates waste in the form of materials that we do not want anymore, such as used packaging, gaseous or liquid emissions, or heat. Some of the

best-known wastes are greenhouse gases, such as carbon dioxide and methane, which contribute to climate change. Much of these polluting gases have been absorbed by the world's oceans, but scientists worry that the oceans' absorptive capacity will soon be overstretched, with the result that more of these gases will go into the atmosphere and accelerate global warming.

Organisations face direct **social-ecological risks** due to these environmental impacts. For example, they may lose reliable access to resources. Social-ecological risks refer to the risks faced by an organisation due to changes in its **social-ecological context**. As a result, some organisations have decided to be proactive and to find ways in which they can address the degradation of the integrity of the biosphere. For example, as part of its 'Good Business Journey', Woolworths is providing proactive support to farmers that supply it with fresh produce. This involves information and techniques for sustainable farming practices that develop soil fertility while reducing the need for water and pesticides. The company is doing so because its managers have realised that if its supplying farmers fail to address water scarcity issues, they will fail to continuously supply Woolworths with high-quality fresh produce.¹⁶

In addition to these longer-term risks, Woolworths and other organisations may face direct costs due to natural disasters, such as fires or floods, which are increasing in frequency and severity due to climate change. This is explained in more detail in the Strategy in action feature on Santam on the next page.

Organisations are also challenged by these environmental risks because they are closely bound up with social and economic risks. For instance, if a drought leads to farmers struggling to produce their crops, this may give rise to growing unemployment, as well as increasing food prices. This can contribute to growing social unrest, which results in potentially violent protests. If protests are not well-managed by the government, they may lead to decreasing confidence among local and foreign investors, which in turn will contribute to worsening unemployment, and so on.

It is thus important to recognise the interrelated nature of social, ecological, political, and other risks in the business context, and how these risks and their interconnections are continuously evolving. It is also important to consider the longer-term social, ecological, technological and political trends that often underlie the business risks. The World Economic Forum publishes an annual report on what business leaders and others identify as the most prominent business risks. These annual reports also highlight the complex interconnections between these risks and underlying trends. For instance, a changing climate increases the risks of extreme weather events, such as droughts or floods, as mentioned above.

Some organisations have recognised that these negative spirals of increasing environmental and social risks can have significant negative impacts on their business prospects. One such example can be seen in how Santam, South Africa's largest and oldest short-term insurance company, went about identifying emerging risks for the company and exploring possible responses. This is described in more detail in the Strategy in action feature below.

STRATEGY IN ACTION: Santam's response to a changing risk landscape



Santam is South Africa's largest and oldest short-term insurance company. Its motto is 'Insurance good and proper'. In 2007-8, strategists at Santam realised that the world was changing rapidly and that the company needed to develop a new strategic response. This was triggered by a range of events, but two were especially important. Firstly, the depth and breadth of the financial crisis became apparent. This not only had important implications for the company's markets, but company leaders also noted that the reputation of finance companies globally was being damaged, even if South African finance companies were not implicated in the same way as those in the USA or UK. Secondly, the company's balance sheet was impacted significantly by increasingly severe and frequent natural disasters. This was particularly evident in the Eden District (including towns like George and Knysna), where large-scale fires and floods caused significant insured losses.

In response, managers organised a scenarios process with the executive leadership of the company in order to identify and prioritise emerging risks for the company. Scenarios are plausible stories about the future, highlighting key trends and their interrelationships. In a scenarios process, managers develop and discuss such scenarios and their implications for the organisation, including both risks and opportunities. One of the Santam managers explained the outcome of this process as follows:

'After the 2008 crash happened we redid our futures scenarios. Five future shaping forces were identified and three of them were not financial... climate change, crime, and gainful employment... and we said, oh, this is interesting; that was the first time that that came up for us.'

Identifying these new 'future shaping forces' had important implications. Because they were new and unexpected, Santam managers grappled with how best to respond to them. They realised that they had more questions than answers. One of the responses was the establishment of partnerships with research organisations and an NGO to explore how the company might better respond to increased risks from natural disasters due to climate change. The result of this was a report that gained international influence. It argued:

'A very encouraging outcome of our work was that for each of the risks we studied (i.e. wild fires, floods, and sea storms), we were able to identify drivers of change in the local landscape that had the same if not greater effect on risk, compared to climatic drivers. Proactive management of these local drivers of risk could therefore offset most of the increased risk associated with climate change. This is the basis of 'ecosystem-based adaptation' to climate change (IUCN 2008).

For wildfires, we identified the occurrence of invasive alien trees as a key driver in the local landscape. The control or eradication of these fire-prone invasive trees provides a practical risk-management response that has the potential of nullifying future increases in fire risk associated primarily with increased temperatures in this region.

For flooding, we identified local changes in land cover, specifically clear-felling of large tracts of commercial forestry plantations that were not replanted and large fires within these plantations, as a key driver of risk. Active rehabilitation of natural vegetation following clear-felling, and improved fire management practices in these areas, are therefore two practical risk management responses. While our study focused on land cover changes related to forestry (due to data availability), it should be noted that other land cover changes such as the degradation of wetlands and river riparian zones could have an equal effect on the risk of flooding. The active rehabilitation of these ecosystems also provides practical risk management responses.'

Importantly, these 'local drivers of risk' were amenable to proactive intervention. However, Santam realised that this was not something the company could do alone. Santam therefore established a partnership with the District Municipality's Disaster Risk Management unit. The objective was to identify ways in which the company could support this unit. This resulted in a range of measures, such as increased training for local fire-fighting departments and sharing flood-risk mapping data.

Questions

1. Why do you think the managers of Santam were surprised by the outcomes of the scenarios planning exercise in 2008? What were the implications?
2. Why did Santam managers partner with researchers and a NGO, and why did they later partner with a municipality – specifically, what abilities or resources did the researchers, the NGO and the municipality have which Santam wanted to make use of?
3. What does this case illustrate about companies' changing risk landscape and how they might respond?
4. Visit Santam's website and try to find information about the company's efforts in response to climate change and in fostering community resilience. Compare this to other insurance companies.

Source: Author interview; Nel, D., Nel, J., Reyers, B., le Maitre, D., Forsyth, G., & Theron, A. (2011). *Insurance in a changing risk landscape: Local lessons from the Southern Cape of South Africa*. South Africa: The Santam Group, WWF, UCT, CSIR. In collaboration with the United Nations Environment Programme Finance Initiative.

2.6 Context as opportunity: Shared value and inclusive business

Strategic managers analyse and respond to context not only to address possible risks, as discussed in the previous section, but also to develop opportunities for competitive and collaborative advantage. In this section, we focus on this mindset, which highlights the opportunities for **shared value** for both the organisation and its key stakeholders. Shared value refers to the benefits that an organisation can create simultaneously for itself and its stakeholders. The related notion of inclusive business prioritises stakeholders that are otherwise excluded from companies' markets or supply chains.

Porter and Kramer develop the idea of shared value as a kind of antidote to what they call 'an outdated approach to value creation that... views value creation narrowly, optimizing short-term financial performance in a bubble while missing the most important customer needs and ignoring the broader influences that determine their longer-term success.'¹⁷ Thus, rather than separate economic objectives to fulfil shareholder demands, on the one hand, and social responsibilities, on the other, Porter and Kramer argue that economic and social objectives must be combined in the pursuit of 'shared value'.

This means that value is not only created for the organisation but a value for society as well as it meets the needs and the challenges it faces.¹⁸

Porter and Kramer identify three dimensions of creating shared value, namely:

- Redefining productivity in the value chain
- Enabling local cluster development
- Reconceiving products and markets.

Let's start with redefining productivity in the value chain. Porter and Kramer explain:

A company's value chain inevitably affects—and is affected by—numerous societal issues, such as natural resource and water use, health and safety, working conditions, and equal treatment in the workplace.

Opportunities to create shared value arise because societal problems can create economic costs in the firm's value chain. Many so-called externalities actually inflict internal costs on the firm, even in the absence of regulation or resource taxes. Excess packaging of products and greenhouse gases are not just costly to the environment but costly to the business. Wal-Mart, for example, was able to address both issues by reducing its packaging and rerouting its trucks to cut 100 million miles from its delivery routes in 2009, saving \$200 million even as it shipped more products. Innovation in disposing of plastic used in stores has saved millions in lower disposal costs to landfills.

The premise of this argument is that organisations can reduce costs in the production and distribution systems, which not only increases their competitiveness, but also reduces negative social and environmental impacts. One of the most important and prominent ways in which organisations are doing this is by reducing their energy and water consumption. This may involve, for instance, installing energy-efficient lighting and heating or using more efficient machines in production systems, as well as installing renewable energy production or water recycling systems. Managers are increasingly making such investments because the pay-offs are compelling.

Sometimes such efficiency gains are remarkably easy and quick to achieve. One of my favourite examples of this is the logistics company UPS. At any given moment, this company has hundreds if not thousands of trucks on the road, often in congested urban areas. Managers came up with an ingenious way to make their trucks' journeys more efficient: they programmed their route planning systems to reduce the number of turns that the trucks make across the ongoing traffic. In other words, if you are driving on the left-hand-side of the road, they made sure that as far as possible, you would be turning left. How does this improve efficiency? If there is a lot of traffic and you need to turn

right, chances are that you will have to wait quite a long time for a chance to turn. This will delay you and it will also contribute to increased congestion, as cars wait behind you. With this small but effective change, they saved millions of rands linked to fuel and time, and they also helped reduce congestion on the roads.¹⁹

Other examples of enhancing productivity are more demanding, but nevertheless provide important benefits to the implementing business, as well as other stakeholders. A good example is Woolworths' 'Farming for the Future' programme, which was mentioned above. It builds on Porter and Kramer's emphasis on 'the advantage of buying from capable local suppliers'²⁰. Woolworths had made a prominent commitment to sustainable development. It also had a strategy of working closely with suppliers to ensure reliable access to high-quality fresh produce. In that context, Woolworths managers noticed a trend of declining productivity on farms, despite an increase in the use of fertilisers and pesticides. This was clearly bad news for farmers, but Woolworths managers realised that it was bad news for Woolworths too. They thus set out to develop a programme of direct engagement with suppliers to enhance their productivity by combining natural farming practices with modern scientific methods, focusing on soil-specific composting and irrigation techniques. The result has been a notable increase in farmers' productivity while the use of pesticides, fertilisers and irrigation water has been reduced.²¹

A second mechanism to create shared value is enabling local cluster development.

Efficient suppliers facilitate logistical efficiency. An example would be a strong transportation service that would boost the industry's productivity. Without this supportive cluster, the productivity would be impacted.²²

The idea of cluster development emphasises that an organisation's success relies on more than its interactions with suppliers and customers and its efforts to stay ahead of the competition. Often it also pays to give attention to the broader organisational 'ecosystem', of which it is a part. The Santam example in the previous section is clearly a good example of this: the organisation recognised that its long-term success relied not only on building its market share, but in ensuring that municipalities and other key role-players are capable of fulfilling their responsibilities. However, if Santam is the only organisation making such efforts, this may give rise to unfair competitive disadvantage, because Santam's competitors are benefiting from its efforts without bearing any of the costs. Hence, part of Santam's strategy has been to involve other insurance organisations in such initiatives.

Finally, a third dimension of creating shared value is reconceiving products and markets. Important gains can be made in developing new business opportunities by better understanding and responding to unmet social needs.

Porter and Kramer mention the example of mobile phones that help the poor not only communicate better with friends and customers but have also enabled better access to mobile banking services, as in the well-known case of M-Pesa.²³

This is closely related to another important idea in business strategy, the 'base of the pyramid', or 'those 4 billion people who live on less than \$2 a day'.²⁴ C.K. Prahalad and Stuart Hart argue that businesses have for too long ignored the unmet needs of the world's poor population, and in so doing, they have also neglected important business opportunities:

*Contrary to popular assumptions, the poor can be a very profitable market – especially if [multinational corporations] change their business models. Specifically, [the poor are] not a market that allows for the traditional pursuit of high margins; instead, profits are driven by volume and capital efficiency.*²⁵

More recent work on this idea has emphasised that the poor should not be seen only as a potential market for business products and services, but also as providers of goods and services in corporate supply chains. Furthermore, because most business managers have limited understanding of the lives and circumstances of the poor, they need to engage in a collaborative process together with the people that they are trying to assist, to make sure that the resulting business model indeed helps.

Business leaders have been enthusiastic about the possibility of developing more inclusive business models. The World Business Council for Sustainable Development argues that there is a strong link between business interests in developing such inclusive business models and the United Nations' Sustainable Development Goals (SDGs):

Companies seeking to expand in emerging markets increasingly see the 4.5 billion people living at the so-called base of the economic pyramid... as potentially important customers, diverse new sources of supply, and strategic distribution and retail partners. Inclusive business can create opportunities for employment and entrepreneurship for people living at the BOP, either directly or through companies' value chains as suppliers, distributors, and retailers. Alternatively, companies can develop ways to supply affordable, high-quality products and services to meet basic needs for food, water, sanitation, housing and health care. Or they can develop innovative business models to enhance access to key development enablers such as energy, communications, financing and insurance. Inclusive business models provide an optimal congruence of private sector and development policy interests and objectives around the SDG agenda.²⁶

However, it is important to note that creating shared value and engaging in inclusive business is not just the domain of large corporations. In fact, entrepreneurs are often particularly adept at creating the kinds of innovations that help address social or ecological challenges at the BOP. This is illustrated by the following Case example, which focuses on a small business that aims to provide access to renewable energy sources to poor people living in rural areas in Zambia. It illustrates many of the mechanisms – and challenges – of creating **shared value**.

CASE EXAMPLE: VITALITE in Zambia

John Fay and Samuel Bell first met in 2005 when they both started working with a natural habitat conservation organisation based in Zambia's Eastern Province. They quickly realised that one of the main factors causing habitat loss was energy demand – trees were being chopped down to be converted into charcoal. A survey of rural farmers indicated a huge gap in modern energy infrastructure: existing technology was either of poor quality or too expensive. In response, John and Sam established a social enterprise called VITALITE Limited in 2013, based in Lusaka. VITALITE started selling solar home systems that made solar power accessible to poor households, combining photovoltaic panels with batteries, lamps, a phone charger, and a rechargeable radio. Initially, they sold these using a cash-and-carry model, in which customers pay for the product upfront. But this was unsuccessful because the poor people they were trying to help could not afford the high upfront costs. They had to find another solution.

They thus developed a 'pay-go' model, which allowed customers to receive, install and use a system without incurring the initial costs. Customers made monthly payments, which worked on a prepaid system: they received a unique code via SMS, which they entered into their solar home system to make it work. VITALITE offered 12, 18 or 24-month rent-to-own contracts, and customers could pay daily, weekly or monthly. This approach was mutually beneficial. It helped customers build their asset base, climb the 'energy ladder' and save money. It helped VITALITE sell its product to its target market, without taking on the liquidity and credit risks plaguing many Zambian microfinance businesses, and it created a credit history for each customer.

But there were still important constraints to growing the market for the solar home systems. Customers generally relied on cash to make payments, so VITALITE was vulnerable to their agents – who collected payments in far-flung rural areas – stealing some of this cash. John's and Sam's response to this challenge was to explore whether they could use mobile payment systems, like the famous payment system developed by M-Pesa in Kenya. However, cellphone use was not as widespread in rural Zambia as it is in Kenya. Also, VITALITE probably would have to collaborate with an existing mobile phone operator to make this work, but this would limit VITALITE's access to this operator's subscribers only. John and Sam came a long way towards making solar energy available to poor, rural residents in Zambia, but growing their reach was clearly a challenge.

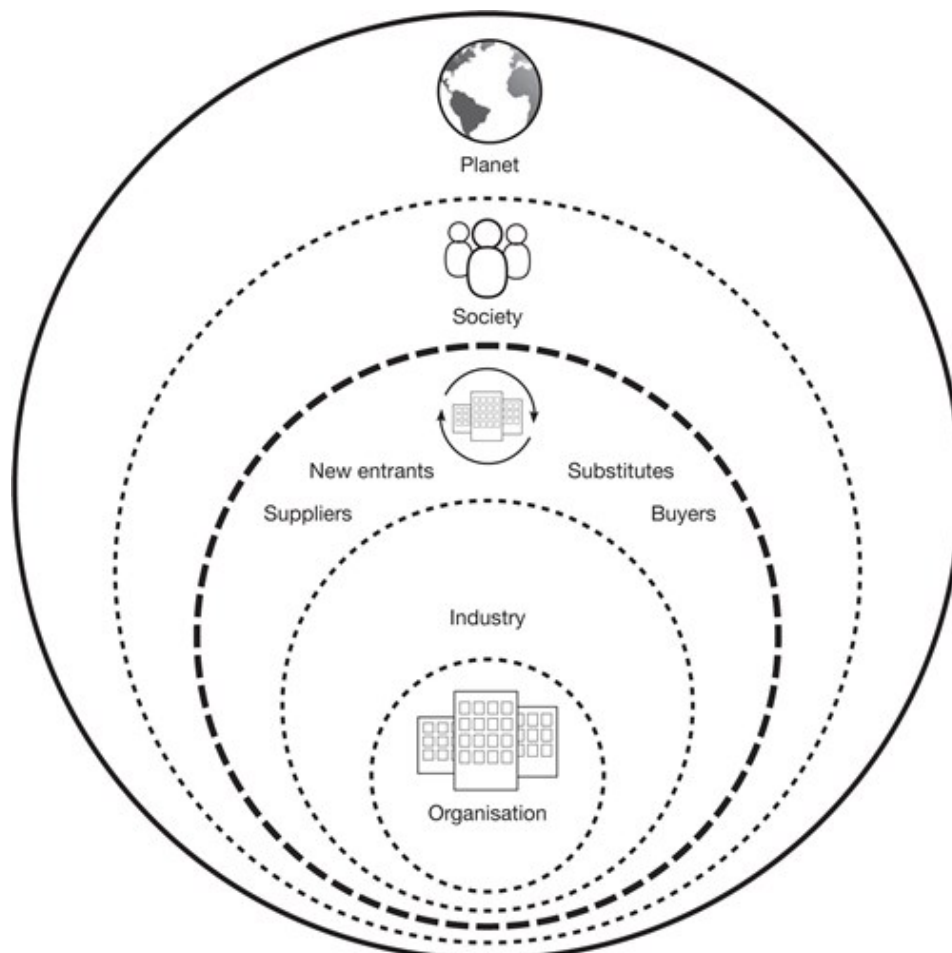
Source: "Vitalite: Shining a light on Zambia," teaching case written by Vimendree Perumal and Ralph Hamann

2.7 The process of embedding context in strategy

Thus far, we have highlighted the importance for strategists of giving careful attention to the purpose and context of their organisation, and to recognise and respond to the risks and opportunities that arise from the context in which their organisations operate. A lot of this has to do with developing an appropriate mind-set and knowledge among managers. However, we also need to give explicit attention to the process of strategy-making. As it turns out, it is possible and helpful to design this process of strategy-making so that the organisation's strategy continuously reflects the organisation's purpose and its dynamic context.

The first step is to recognise your organisation as being part of a 'nested system', in which your strategy needs to take into account competitive dynamics related to your industry, suppliers, buyers, and possible new entrants or substitutes to your product or service – these are the famous 'five forces' highlighted by Michael Porter in his early work on strategy,²⁷ and which will be discussed in more detail in [Chapter 6](#). Importantly, however, all of these dynamics depend on a thriving social system, in which the organisation's stakeholders' well-being is taken care of. This social system, in turn, depends on the natural environment. We have discussed this reliance on natural systems previously in this chapter. The dependence of all our economic activities on social and natural systems is an important foundation for Porter's more recent work on 'shared value', as described in the previous section. It has also been highlighted by prominent business leaders, when they argue, 'business cannot succeed in societies that fail and therefore has a vested interest in stable and prosperous societies'.²⁸ This 'nested system' view of business strategy is depicted in [Figure 2.2](#).

Figure 2.2: A 'nested system' view of business strategy



Source: Bertels, S. and Dobson, R. (2017) *The Road to Context: Contextualising your Strategy & Goals Guide. Embedding Project*. DOI: 10.6084/m9.figshare.3905979

However, business managers can easily become overwhelmed with the many pressing and complex social and environmental issues that pertain to their organisations in one way or another. As noted above, it is often challenging to prioritise diverse stakeholders' claims and expectations. Stephanie Bertels and Rylan Dobson thus explain that it is important to clearly specify an organisation's strategy to respond to social and ecological trends, as well as to understand these trends:

A key part of integrating contextual thinking into a company's strategy involves developing an understanding of socio-ecological trends and their related thresholds and of the magnitude of change required to adhere to them. But it also involves determining the portion of the change that is within the company's responsibility to address (and in what timeframe). Some companies are already starting to set corporate goals in line with these principles...

So, for instance, instead of asking 'how much could we reduce our emissions?' the question becomes 'how much do we need to reduce our own greenhouse gas emissions (and in what timeframe) to do our part in meeting the long-term goal of keeping the increase in global average temperature to well below 2°C above pre-industrial levels?' Companies are already starting to be asked to set 'science-based' or 'context-based' goals and targets. For instance, as part of their annual disclosure process, the CDP (formerly known as the Carbon Disclosure Project) has started asking companies whether they are committing to greenhouse gas emissions reduction targets that support the global effort to limit warming to 2°C.²⁹

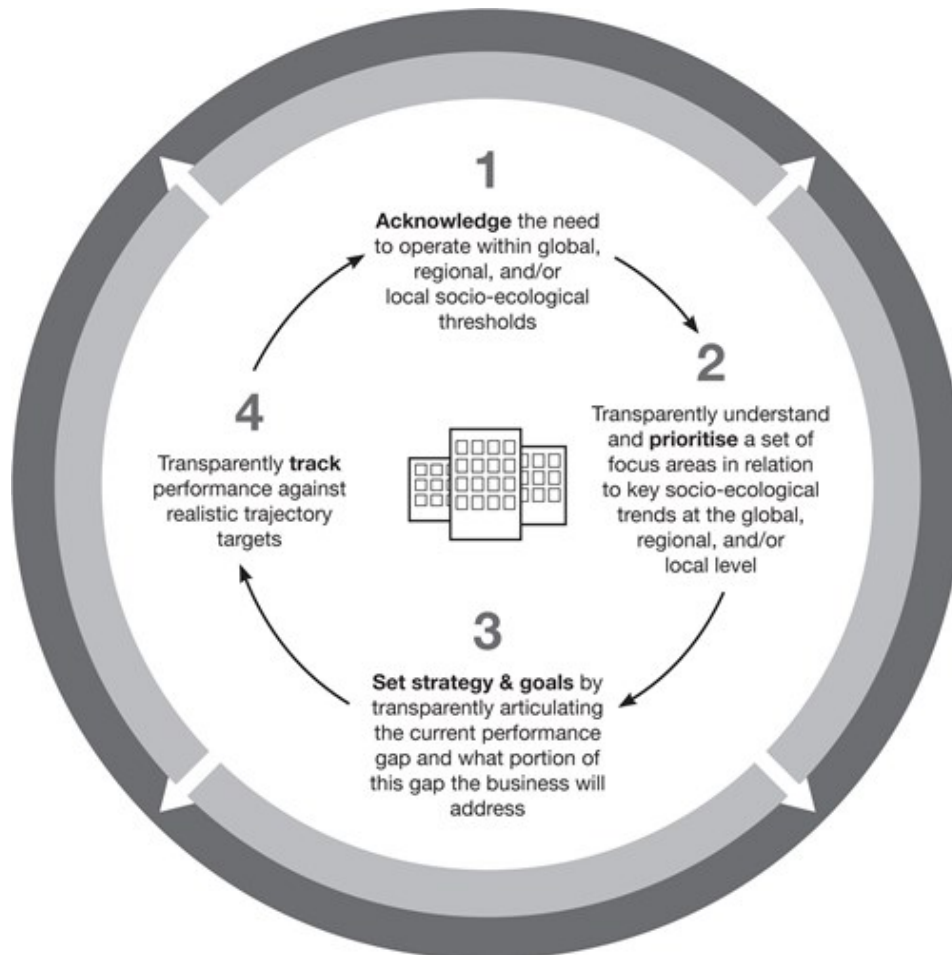
Bertels and Dobson go on to suggest a four-step process to guide managers in identifying and prioritising contextual issues in their strategy-making, as summarised in [Figure 2.3](#). The first step is to acknowledge the need to operate within social-ecological thresholds. As mentioned previously, such thresholds represent conditions in our social and ecological context that may precipitate fundamental, unpredictable, and possibly disastrous changes in these systems, giving rise to circumstances that are extremely adverse for people and organisations. This first step thus emphasises the basic requirement for business leaders to publicly accept that there are such thresholds and that we all need to do what is necessary to remain within these thresholds.

The second step is to prioritise specific focus areas that your organisation needs to give particular attention to. This is generally based on an assessment of how the organisation impacts on its social and ecological context. It may also be informed by analysing where and how the organisation might have the most impact in making a positive difference. There are useful techniques that can help such assessments, such as lifecycle analysis, which involves analysing the social and ecological impacts associated with a particular product or service throughout its life cycle. For instance, Woolworths has done such analyses of some of its most important products, such as milk. This has helped them recognise that many of the most important environmental impacts associated with a bottle or carton of milk are linked to what happens on the farm. This allows the company to focus its strategy on that part of the milk value chain.

The third step is to set strategy and goals that transparently explain how the organisation will contribute to bridging the performance gap between current performance and the desired endpoint. Importantly, the performance gap focuses not only on the organisation itself, but what might be reasonably expected from the organisation to achieve societal progress on the specific issue. Perhaps the most prominent example is in assessing greenhouse gas emissions targets. Many organisations have published reduction targets that correspond more or less with what managers think they can achieve, but we are not often told whether this reduction is aligned with what is needed to avoid catastrophic climate change. The international community has made a shared commitment to maintain climate change to within 2°C; so, companies need to identify their own reduction target to ensure that they are contributing to this global priority.

Finally, the fourth step is to transparently track performance. Once the key strategies and targets have been identified, it is possible to estimate the trajectory that the organisation expects to take to achieve these targets. It thus becomes possible to identify intermediate targets along this trajectory; these can be used to keep track of how well the organisation is doing in achieving its higher-level targets. The challenge and opportunity of measuring and reporting on progress will be addressed in the next section.

Figure 2.3: Four steps for developing contextual strategies and goals



Source: Bertels, S. and Dobson, R. (2017) *The Road to Context: Contextualising your Strategy & Goals Guide. Embedding Project*. DOI: 10.6084/m9.figshare.3905979

Context-based strategy-making is thus a continuous process of linking broader societal ambitions and requirements – at global, national, and local levels – to the specific circumstances of your organisation. The Strategy in action case on Nedbank’s Fair Share 2030 below illustrates the concept of context-based strategy-making in South Africa.

STRATEGY IN ACTION: Nedbank’s Fair Share 2030 as an example of context-based strategy

Nedbank is one of South Africa’s four large banks. It has a long history of incorporating environmental and social issues into its strategies and practices. This includes the establishment in 1990 of the WWF Nedbank Green

Trust to raise funds for conservation projects. Nedbank was also South Africa's first signatory to the Equator Principles, which identify social and environmental safeguards to assess projects prior to agreeing to finance them. Nedbank also made important steps to provide funding for South Africa's renewable energy programme.

In 2011, however, Nedbank managers realised that in order to live up to the company's vision, 'To be Africa's most admired bank,' they would need to find a way to more authentically and effectively contribute to addressing some of South Africa's most material sustainability challenges – those that were preventing the creation of a flourishing society and a vibrant and resilient economy that respected environmental limits. This resulted in the launch of 'Fair Share 2030' in 2014, which aims to shift Nedbank's lending practices away from activities that negatively impact on poverty and environmental and societal risks, redirecting those funds to helping to build resilience and well-being in South Africa.

Nedbank managers thus acknowledged social-ecological thresholds, prioritised focus areas, and set corresponding goals. As argued by Mike Brown, Nedbank's Chief Executive: 'We know not everything that needs to be done can or should be done by a bank. So, we identified goals that we can contribute to as a bank.' This involved the overarching goal of lending no less than R6 billion to activities that align with eight more specific long-term goals.

Finally, tracking progress was a vital part of this strategy, allowing for a comparison of progress achieved against both the overarching goal and the more specific goals. This also informed a subsequent, more recent shift in this strategy, which identified the SDGs as a vital, global set of goals informing the company's strategy, as explained by the company on its website:

'In 2015 and 2016 we had set a stretching R6 billion annual lending target to encourage new and innovative lending with deliberate social and environmental impact. While we did not meet the target in either year (R2,3 billion in 2016 and R1,8 billion in 2015), the outcome of our lending provided much-needed student accommodation across the country and supported the rollout of additional embedded energy installations... It also provided opportunities for the bank to learn more about sustainable development finance as a driver of value in tough economic times, within a limiting regulatory environment.

Aligned with our purpose, a broader approach is being adopted for Fair Share 2030. One of the key changes is that the R6 billion annual target will be replaced by a larger cumulative target for sustainable development finance up to 2020. This cumulative target will be expressed as a set of outcomes aligned to the SDGs.³⁰

Questions

1. Why do you think Nedbank called this strategy 'Fair Share 2030'?
2. Why do you think Nedbank focused on its lending practices? Do you think this was a good focus?
3. Visit Nedbank's website and see how they are reporting on progress in implementing this strategy: what can you identify as challenges in the implementation process? Compare Nedbank to one or more other South African or international banks.

2.8 Measuring and reporting on progress

As emphasised in the model of context-based strategy-making process above, transparently tracking progress is vital. Indeed, reporting on the implementation of strategy to both internal and external stakeholders is a key ingredient of most management systems, which focus on continuous improvement. The management scholar Deming emphasised this as part of the so-called Deming Cycle – also known as the Plan, Do, Check, Act Cycle. Take another look at [Figure 2.3](#) and you will recognise this cyclical process of identifying objectives, implementation, checking progress, and adjusting the strategy in response.

In other words, reporting on progress is a vital component of designing and implementing strategy. But there are additional reasons for this as well, especially because businesses are being held to account more and more, not just on their financial performance but also their social and environmental performance. This has led, among other things, to the **integrated reporting** movement. In the past, most publicly listed companies published an annual report that focused on its financial performance, and then a separate sustainability report that focused on

environmental, social, and governance (or ESG) issues. Integrated reporting requires that companies publish just one report that integrates economic, social, environmental, and governance concerns. South Africa was the first country in the world in which the stock exchange made integrated reporting a requirement for all listed companies, based on the King III Report on Corporate Governance.

At the global level, the move towards integrated reporting is being led by the International Integrated Reporting Council. Its discussion document defines and motivates for integrated reporting as follows:³¹

Integrated Reporting brings together material information about an organisation's strategy, governance, performance and prospects in a way that reflects the commercial, social and environmental context within which it operates. It provides a clear and concise representation of how an organisation demonstrates stewardship and how it creates and sustains value. An Integrated Report should be an organisation's primary reporting vehicle.

The Integrated Reporting framework goes on to identify the following key principles of integrated reporting, namely strategic focus, connectivity of information, future orientation, responsiveness and stakeholder inclusiveness, conciseness, reliability and materiality:³²

- *Strategic focus*: An Integrated Report provides insight into the organisation's strategic objectives, and how those objectives relate to its ability to create and sustain value over time, and the resources and relationships on which the organisation depends.
- *Connectivity of information*: An Integrated Report shows the connections between the different components of the organisation's business model, external factors that affect the organisation, and the various resources and relationships on which the organisation and its performance depend.
- *Future orientation*: An Integrated Report includes management's expectations about the future, as well as other information to help report users understand and assess the organisation's prospects and the uncertainties it faces.
- *Responsiveness and stakeholder inclusiveness*: An Integrated Report provides insight into the organisation's relationships with its key stakeholders, and how and to what extent the organisation understands, takes into account and responds to their needs.
- *Conciseness, reliability and materiality*: An Integrated Report provides concise, reliable information that is material to assessing the organisation's ability to create and sustain value in the short-, medium- and long-term.

Finally, the Integrated Reporting framework provides an outline of the content of an integrated report:³³

- *Organisational overview and business model*: What does the organisation do and how does it create and sustain value in the short-, medium- and long-term?
- *Operating context, including risks and opportunities*: What are the circumstances under which the organisation operates, including the key resources and relationships on which it depends, and the key risks and opportunities that it faces?
- *Strategic objectives and strategies to achieve those objectives*: Where does the organisation want to go and how is it going to get there?
- *Governance and remuneration*: What is the organisation's governance structure, and how does governance support the strategic objectives of the organisation and relate to the organisation's approach to remuneration?
- *Performance*: How has the organisation performed against its strategic objectives and related strategies?
- *Future outlook*: What opportunities, challenges and uncertainties is the organisation likely to encounter in achieving its strategic objectives, and what are the resulting implications for its strategies and future performance?

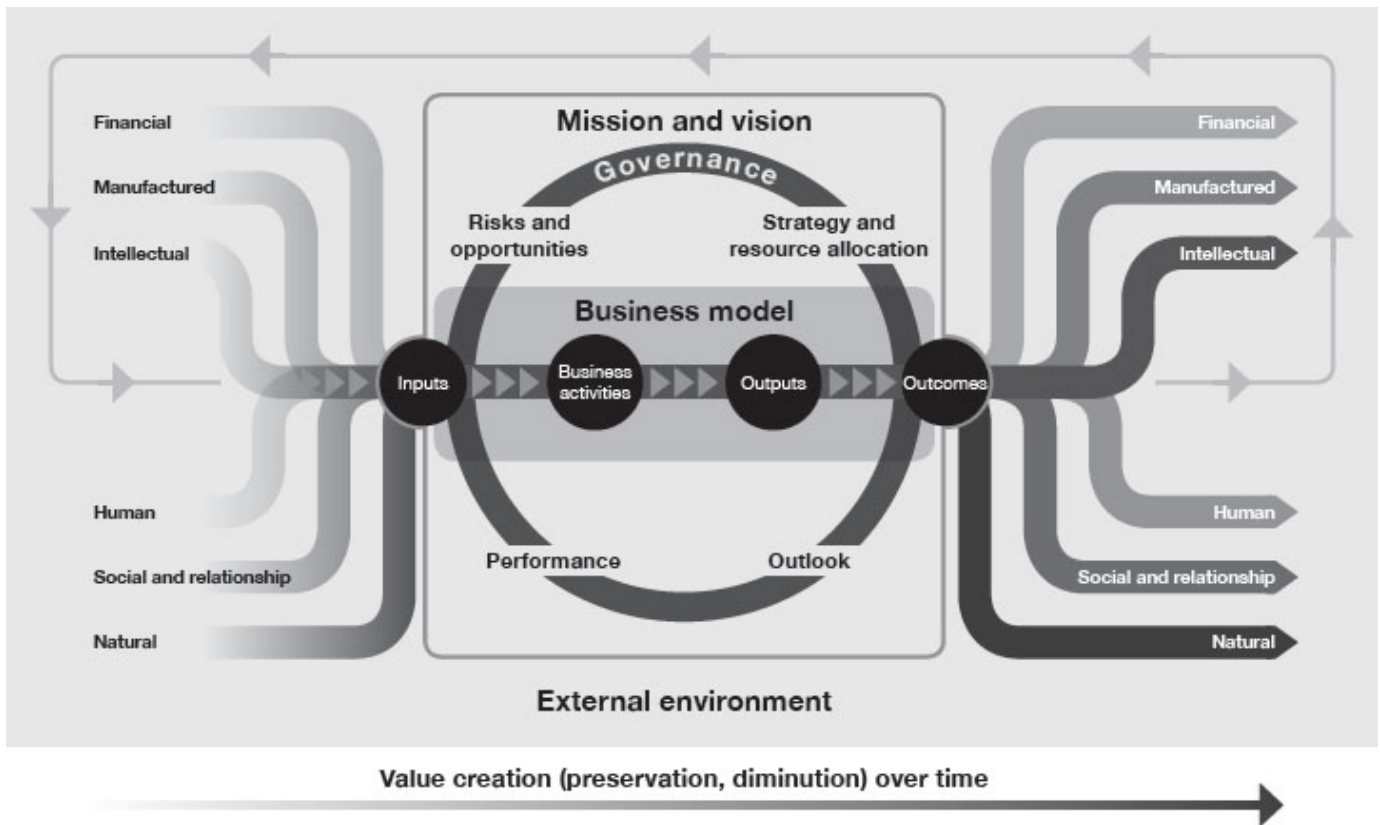
From these principles and content requirements, you can see that integrated reporting is based on a view of strategy that is very much aligned with what we have been focusing on in this chapter – that is, an emphasis on purpose and context, on associated risks and opportunities, and on the need for long-term value creation for stakeholders. In line with this broader emphasis on an organisation's social and ecological context, a vital aspect of integrated reporting is

that it focuses attention not only on financial capital, but a more holistic set of six capital forms – defined as ‘stocks of value that are increased, decreased or transformed through the activities and outputs of the organisation³⁴’. Over and above financial capital, managers should consider:

- *Manufactured capital*: ‘Manufactured physical objects (as distinct from natural physical objects) that are available to an organisation for use in the production of goods or the provision of services³⁵, such as buildings or equipment
- *Intellectual capital*: Both the tacit knowledge of employees and the explicit knowledge of the organisation, such as patents or software
- *Human capital*: The organisation’s access to ‘people’s competencies, capabilities and experience, and their motivations to innovate³⁶’
- *Social and relationship capital*: ‘The institutions and the relationships within and between communities, groups of stakeholders and other networks, and the ability to share information to enhance individual and collective well-being³⁷,’ including shared norms and **values**, and key stakeholder relationships
- *Natural capital*: ‘All renewable and non-renewable environmental resources and processes that provide goods or services that support the past, current or future prosperity of an organisation³⁸’.

These six capital forms are inputs into an organisation’s value creation process, as well as outcomes, as illustrated in [Figure 2.4](#). Integrated reports should thus consider these diverse forms of capital both as inputs and outcomes. Many of the examples that we considered in this chapter may be interpreted using this view of the ‘six capitals’ and their role in a business model. For instance, when Woolworths managers established the ‘Farming for the Future’ programme to support suppliers by enhancing their farming practices and improving soil fertility, they recognised that soil fertility on these farms was a crucial form of natural capital that is an input in their business model. When VITALITE managers explored different options for their customers to pay for solar energy, they were trying to innovate their business model to account for customers’ limited incomes. When Patagonia tried to convince customers not to buy a new jacket but rather get their existing jacket fixed instead, they were trying to reduce their impact on the natural environment (as an output), while at the same time increasing customer loyalty (as an input).

Figure 2.4: The six forms of capital as inputs and outcomes of a company’s value creation process.



Source: IIRC (2013), page 13.

2.9 Summary

This chapter covered organisational purpose and context as vital elements of strategy. To identify strategic objectives and priorities, we need to define and agree on the purpose of our organisation? To define our objectives and corresponding targets, we need to understand and respond to the changing context in which we are operating? We are now better able to design and implement strategy that shifts from short-term returns focus for shareholders to longer-term value creation for a range of stakeholders. This includes identifying and responding to diverse risks and opportunities that arise from our context, recognising the potential for turning social problems into business opportunities. We also understand that strategy-making is an ongoing process, in which we keep asking ourselves key questions about our purpose and context, in order to set goals that contribute to our 'fair share' of achieving the Sustainable Development Goals. Finally, we have learned that transparently tracking progress is a vital ingredient of this strategy-making process. Organisations' integrated reports are thus important mechanisms to transparently communicate progress; this in turn should help managers improve their strategies.

Opening case study questions

Return to the Opening case study and consider the following:

1. How does Patagonia define its purpose, and how does this influence its strategy and its distinctiveness?
2. How is the company's purpose related to its approach to the relationship between shareholders and stakeholders, and to its approach to short-versus long-term time horizons?
3. What risks is Patagonia trying to respond to in its strategy, and what risks might you identify for its strategy – especially with regard to its activist stance?

4. What opportunities is Patagonia trying to develop through its strategy?
5. Read the article in *FastCompany* listed as the final reference in the Opening case study. What is the company doing to be a more inclusive business?
6. Take a look at Patagonia's website. How well is the company reporting on its strategy and its link to context?

Discussion questions

1. Is it important for organisational leaders and other members to think and talk about their organisations' purpose? Why?
2. How does the timeframe – that is, short- or long-term thinking – impact strategy-making? How might you motivate for longer-term thinking to be included?
3. Shareholders are clearly a vital constituency when designing and implementing strategy, but why is it important to also consider a broader array of stakeholders? How might you develop different approaches for responding to different stakeholders?
4. What are some of the important social-ecological trends and the corresponding risks for businesses, both at the global level and in South Africa?
5. What do we mean by 'creating shared value' and inclusive business models, and how might you go about addressing such opportunities in business strategies?
6. What are the key steps in embedding contextual issues into the strategy-making and implementation process?
7. Why is the emerging practice of integrated reporting an important aspect of strategy formulation and implementation? What do you think might be associated difficulties and how might you respond to them?

Using knowledge and skills

Please select an organisation of your choice. You may want to select one of the organisations that we have given special attention to in this chapter, such as Nedbank, Santam, or Woolworths. Visit the organisation's website and download their most recent Integrated Report. See if you can answer the following:

1. How is the organisation's purpose defined and to what extent do you see it shaping the organisation's strategy?
2. How is strategy informed by an analysis of the organisation's context? How does the context translate into risks and opportunities for the organisation?
3. How are strategic goals identified, and how do they account for context and agreed national or international development targets?
4. How well do you think the Integrated Report fulfils the need to keep you, as a stakeholder, informed about progress in fulfilling the organisation's strategy?

Suggested websites

<https://embeddingproject.org>

<https://sdgcompass.org>

<https://www.wbcsd.org>

<http://www.nbi.org.za>

<http://integratedreporting.org>

<https://www.globalreporting.org>

<https://nbs.net>

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<https://www.weforum.org>

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23. Adapted and reprinted with permission from The Fortune at the Bottom of the Pyramid from the First Quarter 2002 issue of *strategy+business* magazine. © 2002 PwC. All rights reserved. PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see

<http://www.pwc.com/structure>“ \t”_blank” www.pwc.com/structure for further details. <http://www.strategy-business.com/> \t “_blank” www.strategy-business.com

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CHAPTER 3

Strategic direction

Mari Jansen van Rensburg

LEARNING OUTCOMES

After reading this chapter, you should be able to:

- justify the indispensability of a clear strategic direction for an organisation
- explain what strategic intent is
- explain what a vision statement is, and justify its role as the basis of the organisation's strategy
- explain what a mission statement is, and explain how it is aligned with the vision statement
- expound on the components of a mission statement
- critically evaluate the way that strategic direction is expressed by an organisation
- explain the alignment between an organisation's strategic direction and strategic objectives
- explain the alignment between an organisation's strategic direction and its operational level.

KEY TERMS

balanced scorecard

mission statement

strategic intent

value statement

vision statement

OPENING CASE STUDY



King Price Insurance^{1, 2, 3, 4, 5}

Super cheap insurance premiums and they decrease every month – is this madness?

When King Price Insurance, a new player in the short-term insurance industry, was officially launched in June 2012 many industry stakeholders and potential clients questioned the sanity of the potentially ground-breaking insurance model employed by this company. This Opening case study tells the story of a man with a dream of disrupting the local insurance market by providing a comprehensive insurance cover with premiums that

decrease monthly as the values of the insured cars depreciate. As the name of the company suggests, it also comes with royal service.

I too was a disgruntled client ...

In 2008, Gideon Galloway was the youngest board member of a well-established organisation and at the height of his career. Despite his apparent success, this young man was frustrated. Like the clients served by his company, he too was disgruntled about paying more for car and home insurance than was necessary. He wanted to change this, but found that there was an unwillingness to change and improve. There simply was no room for innovation due to limited resources and old system technologies. Driven by a strong conviction that he could turn the market on its head, he took a leap of faith and left his current employment to pursue a dream which, at the time, seemed almost impossible.

King Price: Premiums that decrease monthly

With a vision as clear as daylight, very little start-up money, and the assistance of an extraordinary crew, Galloway built this company from a garage and created the insurance company of tomorrow. The pillars of the new business model were the following:

- A team of experts: Galloway was joined by a team of seasoned insurance experts and technology gurus who shared his vision.
- Solid market research: Market research on the short-term insurance industry found that the motor industry, followed by property, were the largest income contributors in this sector. These sectors became the initial focus of the company.
- A highly sophisticated intelligent risk-rating system: The company engineered state-of-the-art software which they considered to be 'the most intelligent, accurate and fastest risk-rating engine in South Africa.' They believe that accurate calculation of risks translates into client savings.
- A world-first pricing strategy that sees comprehensive car premiums decreasing monthly as the cars lose value.
- An established global reinsurance provider: The company is underwritten by Munich Re, which is considered to be a reinsurer of choice, hence its position as the world's largest reinsurance firm.

The business model of King Price Insurance was developed to address the weaknesses in other insurers' offers. The founders of the company firmly believe that it is possible to make a reasonable profit and still cover risk at a most competitive rate. As a result, they adopted a lean and mean policy, and an aggressive but transparent discounted pricing policy. The bottom line for this company is that price is king.

In line with this strategic thrust, the company announced that their comprehensive car premiums would decrease every month. The logic behind this point of differentiation was based on standard depreciating vehicle values against which insurance premiums decrease monthly. In addition to this exciting new way of doing insurance, King Price also removed all the frills and non-essential added benefits. What's the point of having insurance if you're incentivised to not use it when you need to? We'd rather all our clients benefit from super cheap insurance and premiums that decrease monthly, from the get-go. According to Galloway, 'Clients don't realise that insurers are regulated to reserve a percentage of premiums for the "no-claim bonus" fund'. Instead of earning this bonus, Galloway believes that it would be to the clients' benefit to 'reap the benefit of a substantially discounted premium immediately'.

Following a clear strategic direction seems to have paid off, and by September 2014 more than 100 000 new policies had been sold. However, despite impressive growth King Price did not become complacent, but instead continued to challenge the status quo. In line with customer needs and market opportunities, they extended the scope of insurance coverage. R1 insurance is another innovation. We grew our company by expanding our product offering to include cover for buildings, home contents, portable possessions, motorbikes, watercraft, caravans and trailers. We also launched value-add products like credit shortfall, car warranty, and scratch and dent cover. One of our sayings is, you own it, we'll cover it. We've also launched community and business insurance divisions, and we cover specialised risks like agri and engineering. We opened a kingdom in Namibia and are looking to expand into Europe soon.' The company seemed to go from strength to strength.

Overview

An organisation's strategic direction informs and shapes how it defines itself, and where it finds its unique strategic advantage. It requires organisations to ask themselves: 'What is our fundamental purpose?' An organisation, therefore, whether developing a new business or reformulating its current business, must determine the basic goals and values (or philosophies) that will shape its strategic posture. If this is done correctly, it becomes much more than words on paper – it becomes the heart and soul of the organisation! This chapter considers the tools we use to determine the strategic direction of an organisation, namely strategic intent, and vision, mission and value statements. This chapter also introduces another strategic tool, the balanced scorecard. This helps organisations translate their strategic direction into operational objectives that provide direction for all levels and areas of the organisation.

3.1 Introduction

In the Opening case study you will not find any formal statements communicating the company's strategic direction. Instead, Gideon Galloway, the founder and CEO, had a vision as clear as daylight – premiums that decrease monthly and royal service. He realised, however, that initially he had other things to concentrate on before he could set his vision in motion. In fact, he and his team went, as they call it, 'underground' for almost four years to get their ducks in a row. Before they could open their doors on 2 June 2012, they did extensive research to ensure that their discounted premium model was sustainable and scalable. The company also developed a highly sophisticated intelligent risk-rating system and partnered with an established global reinsurance provider. Both elements are key requirements in a cut-throat insurance industry.

Although Galloway did not articulate these strategic views in well-formulated vision and mission statements, he never lacked strategic direction as he clearly identified and communicated what the business should be about, and how he planned to achieve his objectives. This clear direction created a central theme that became the basis of all decisions and actions, i.e. provide insurance that makes sense?

Although this sounds relatively simple, ensuring that the behaviours of diverse people unite around a central theme is one of the major challenges for top management.⁶ In this context, the most important tools management uses to develop and convey strategic direction are strategic intent, vision, mission and **value statements**.⁷ It is important to note that organisations do not necessarily use all these tools. Some combine them and present their strategic direction as a credo. Others decide to use only some of them. King Price states publicly that it does not like rules or statements, and expresses its way of doing things as values, as illustrated in the Case example about King Price later in this chapter. Pick n Pay uses mission and value statements to convey its strategic direction, yet others use different terminology to describe their strategic directions, for example a purpose statement instead of a mission statement, or an organisational philosophy rather than organisational values. Regardless of the selection of tools and terminology used, it is important to determine the strategic direction as the first step in, and underlying foundation of, strategic planning.

Both **strategic intent** and vision contain 'a conviction to achieve a certain state of affairs in the future'.⁸ The difference between a strategic intent and vision is the 'degree of collectivity'. Strategic intent is considered to be a 10- to 20-year quest 'diffused at multiple organisational levels, while a vision statement is more clearly a top management leadership tool often ascribed to a single visionary leader'.⁹ A **mission statement**, however, reflects on what an organisation should be to achieve its purpose. The mission statement thus stipulates the nature of the business, and the customers it seeks to serve and satisfy. Because these statements consider the purpose of the organisation, they can guide employee behaviour when supplemented by value statements. A **value statement** reflects the future standing of the organisation, and typically comprises a set of key values or behaviours to which

employees should subscribe.¹⁰ The **values** espoused in the vision and mission statements, and summarised in the value statement, can act as a powerful pull for people who identify with them, and can motivate them to perform passionately. The value congruence between the principles of an organisation and those of its members can transform ordinary jobs into a mission, giving employees a higher-order meaning.¹¹ To realise the shared conception of the future, we will introduce the balanced scorecard as a strategic tool to help the organisation deliver results. The balanced scorecard is a framework used to translate strategic direction into actionable chunks and financial and non-financial measures. As such, scorecards create a shared understanding, consensus and commitment which are key for successful implementation.¹² The discussion below explores these concepts in greater depth.

3.2 Strategic intent

Hamel and Prahalad¹³ introduced the concept of strategic intent in 1989 to address different notions of competitive strategy expressed and practised by Western and Far Eastern organisations. At the time they argued that Western organisations focused on trimming their ambitions to match their resources and, as a result, searched only for those advantages they could sustain. They called this maintaining strategic fit. By contrast, Japanese organisations leveraged resources by accelerating the pace of organisational learning and tried to attain seemingly impossible goals. To do so, Japanese organisations fostered the desire to succeed among their employees, which they maintained by spreading the vision of global leadership. These different approaches created an upset in the global competitive balance.¹⁴

In a quest to understand which approach, i.e. Western or Eastern, was the most successful, Hamel and Prahalad¹⁵ studied organisations across the world that had risen to global leadership. They observed that these organisations invariably began with ambitions that were out of proportion with their resources and capabilities. However, the organisations succeeded by creating an obsession with winning at all levels within the organisation. Hamel and Prahalad¹⁶ termed this obsession 'strategic intent'. According to these authors, strategic intent envisions a desired leadership position as well as the criteria to be used to measure progress. At the time, the best-known examples were Komatsu's intent to 'encircle Caterpillar', Canon's aim to 'beat Xerox', and Honda that set out to 'become a second Ford'.

Hamel and Prahalad¹⁷ also noted that strategic intent was more than an unfettered ambition as it also had to 'encompass an active management process that includes focusing the organisation's attention on the essence of winning, motivating people by communicating the value of the target, leaving room for individual and team contributions, sustaining enthusiasm by providing new operational definitions as circumstances change, and using intent consistently to guide resource allocation'.¹⁸ Strategic intent therefore captures the essence of winning, setting out a 10- to 20-year quest for global leadership.

Given the accelerated pace of change in the contemporary competitive environment, it is virtually impossible to plan for such a long-term quest. The odds of an organisation reaching a leadership position within its field (industry) without having a clear strategic intent are remote. The chance of falling into a leadership position by accident is, however, also remote. Organisations therefore need a driving force, or strategic intent, that will inform and shape how they define their business, and where they find their unique strategic advantage. A clear strategic intent gives managers a central point of departure from 'which to make decisions about the future of their organisation and to assess product options and market decisions'.¹⁹ This notion also applies to the public sector. Consider, for example, the South African Vision 2030, which is included below as a Case example.

Organisations, or governments, that lack a clear strategic intent and clear leadership often face conflicting priorities, wasted resources, indecision, frustration in the workforce, and confusion in the marketplace. 'When

priorities conflict and scarce resources must be allocated, managers need to know how to make the tough decision. They need a touch point which shapes the future and explains the past.²⁰ Compared to a strategic intent which is a 10- to 20-year quest and diffused at multiple organisational layers, a vision statement is often ascribed to a single visionary leader. In the next section, we will consider the content of vision statements and the best practices used to implement them.

CASE EXAMPLE: South African Vision 2030

The National Development Plan 2030 sets out how to achieve 'a country that is just, fair, prosperous and equitable. A country that each and every South African can proudly call home'. Although the plan is based on extensive research, consultation and engagement, and sets out firm proposals to solve the country's problems, the execution remains the responsibility of the elected president.²¹ This official needs to have a shorter-term vision for what he or she wants to achieve. Here the strategic intent is as follows:

By 2030:

- Eliminate income poverty: Reduce the proportion of households with a monthly income below R419 per person (in 2009 prices) from 39% to zero.
- Reduce inequality: The Gini coefficient should fall from 0.69 to 0.6.²²

3.3 Vision statements

Similarly to strategic intent, a **vision statement** also goes beyond mere planning and strategy by challenging organisational members to go beyond the status quo in pursuit of a long-term goal. While a vision statement is similar to strategic intent in its emotional effects, it goes further as it has connotations of encouraging strong corporate values in the strategic process. 'The most striking difference between visions and strategic intents is the degree of collectivity, as many authors ascribe a strategic intent as a phenomenon diffused at multiple organisational levels, while a vision is more clearly a top management leadership tool, often ascribed to a single visionary leader.'²³

Both strategic intent and vision are important as the theory of reasoned action proposes that people need a reason for an action. Thus, if an organisation wants its employees to give their best performance, it should provide them with a proper reason for doing so. The role of the leader is to set a vision and ensure that people not only see it, but also live and breathe it in their actions. Such shared purpose could be fostered through a vision statement, which can serve as a guide to an organisation by providing direction of progress and by indicating the core ideology to be preserved. The core ideology defines the enduring character or consistent identity of the organisation, and comprises the core values and core purpose (reason for being). Vision involves answering questions about the organisation's identity such as who it is, where it is going, and what its guiding values are. It is important to note that for a vision to become a reality it must be communicated and lived.²⁴

Hitt, Ireland, and Hoskisson²⁵ considered a vision to be a picture of what the organisation wants to be and, in broad terms, what it ultimately wants to achieve. The vision statement should therefore articulate the ideal description of the organisation and give shape to its intended future. These authors also emphasised that it is important for a vision statement to reflect an organisation's values and aspirations that capture the hearts and minds of all its employees, and, hopefully, many of its stakeholders. In addition, a vision stretches and challenges people by motivating staff to contribute to a bigger picture.²⁶ The uniqueness of each organisation determines the content of its vision statements. Compare, for example, the vision statements of Avis and Coca-Cola presented in the Case example below.

CASE EXAMPLE: Vision statements: Illustrating unique approaches

Vision statements illustrate the unique approach of a company. Read the vision statements of Avis and Coca-Cola below.

Avis: To exceed customer expectations at every interface²⁷

Coca-Cola: Our vision serves as the framework for our roadmap and guides every aspect of our business by describing what we need to accomplish in order to continue achieving sustainable, quality growth.

- People: Be a great place to work where people are inspired to be the best they can be.
- Portfolio: Bring to the world a portfolio of quality beverage brands that anticipate and satisfy people's desires and needs.
- Partners: Nurture a winning network of customers and suppliers. Together we create mutual, enduring value.
- Planet: Be a responsible citizen that makes a difference by helping build and support sustainable communities.
- Profit: Maximise long-term return to shareowners while being mindful of our overall responsibilities.
- Productivity: Be a highly effective, lean and fast-moving organisation.²⁸

Although the vision statements of Avis and Coca-Cola differ in terms of length and scope of content, both seem to adhere to the requirements set for visions, and confirm that each organisation requires a unique approach. The discussion below focuses on different approaches used to develop a vision statement, the attributes and content of vision statements, and how to implement them.

3.3.1 The visionary process

There is much disagreement about the process an organisation should use to develop a vision statement. Some argue that a vision is developed, while others maintain that it exists in the organisation and should be discovered.²⁹ Regardless of the process followed when developing a vision statement, it is important to point out that setting the vision is a creative process. The implication of this, of course, is that it is not possible to judge a particular vision as right or wrong. Just as one cannot suggest that Shakespeare wrote the wrong *Macbeth* or that Queen composed the wrong 'We will rock you', one cannot say that Eskom's vision is 'wrong'. While one may not like a particular vision statement, all that really matters is whether it works for the organisation or not.

It is the responsibility of the organisation's most important and prominent strategic leader (in most cases the CEO) to develop a vision. Experience shows, however, that the most effective vision statement results when the CEO involves a host of people to develop it, and when the statement is clearly tied to the conditions in the organisation's external and internal environment.³⁰ A comprehensive literature review conducted by Foster and Akdere³¹ on this topic revealed three basic approaches applied to develop a vision, namely the intuitive approach, the analytical approach and the benchmark approach.

- The *intuitive approach* is based primarily on structured introspection. The resultant visions can take many different shapes due to differences in leaders and in leadership styles.
- The *analytical approach* focuses on gathering information from various individuals about the direction of the organisation. Owing to the complexity of individual perceptions, this participative approach requires strong leadership in the process, and in the promotion and support of that vision.
- Finally, the *benchmark approach* looks to the competition for standards, and creates a vision based on subsequent findings.³²

3.3.2 The vision content

The attainment of a vision requires a certain level of unreasonable confidence and commitment. This is called strategic stretch. As Collins and Porras³³ emphasised that the foretold future should produce some sense of caution and concern. This will be more evident when future activity unfolds and people realise what what to be done in order to accomplish the goal.³⁴ The content should thus support such a challenge.

Considering the format of the vision statement, Foster and Akdere³⁵ provided some useful guidelines pertaining to the attributes associated with and the proposed content of visions. First, the authors identified attributes necessary for a vision to be effective. These are brevity; clarity; abstractness; challenge; future orientation; focus; understandability to all employees; stability; and the ability to inspire. Second, the authors researched the content that explicitly describes what should be included in a vision. Results revealed that most authors identified the organisation's core ideology or philosophy as well as the organisation's values to be key ingredients in vision statements. Other descriptors associated with vision statements included action orientated; responsive to competition; long term; purposeful; bottom-line orientated; setting audacious or ambitious goals or challenges; product of leadership; focused; strategic; flexible; and planned.³⁶

A vision statement should be short and concise so that stakeholders can relate to it and use it to direct daily decisions.

3.3.3 Vision implementation

In some organisations, a vision statement might grace the walls of the boardroom, or it might appear on websites and in marketing material, but it fails to capture the hearts and minds of employees. 'As is true for any plan, if vision does not take on meaning for individuals and the organisation as a whole, it isn't worth the time spent crafting it.'³⁷ Successful 'implementation requires either an extremely clear and meaningful vision, or someone who can decode or translate the vision into meaningful parts'.³⁸ Without such clarity and the required leadership, a vision is indeed a daydream, and the nightmare starts when undirected actions result in poor performance.

As a vision statement gives people a sense of meaning in their work, leaders should aim to make people excited about their view of the future while inviting others to help crystallise that image. 'If they realise other people aren't joining in or buying into the vision, they don't just turn up the volume; they engage in a dialogue about the reality they hope to produce. They use stories and metaphors to paint a vivid picture of what the vision will accomplish, even if they don't have a comprehensive plan for getting there. They know that if the vision is credible and compelling enough, others will generate ideas to advance it.'³⁹ Leaders who excel in visioning are said to 'walk the talk' – their own behaviour and conduct should therefore embody the core values and ideas contained in the vision statement.⁴⁰

It is also important never to underestimate the power of a vision. It is so easy for those who are intimately involved with the 'hard' aspects of the business, such as engineers and accountants, to denigrate its 'soft' aspects, such as people management and visions, without realising the potential effect of clear vision.

Finally, organisations must also be careful of the 'We have arrived!' syndrome.⁴¹ Visions are expected to be achieved, and by the time this happens, the next vision should have been timeously set. Failure to do so will result in complacent lethargy because a vision is the energising force of any organisation. It is also important to emphasise that a vision is not a magic potion. All it does is provide the context for awakening the dynamism that exists in any organisation. Building a visionary organisation requires 1% vision and 99% alignment. Notwithstanding the importance of vision and the fact that it is the first indispensable step of strategic management, its impact will be negligible unless the rest of the organisation is closely aligned to and supportive of it.

The Strategy in action feature below about Samsung shares some insights on the importance of a clear vision in an industry where the only constant is change.

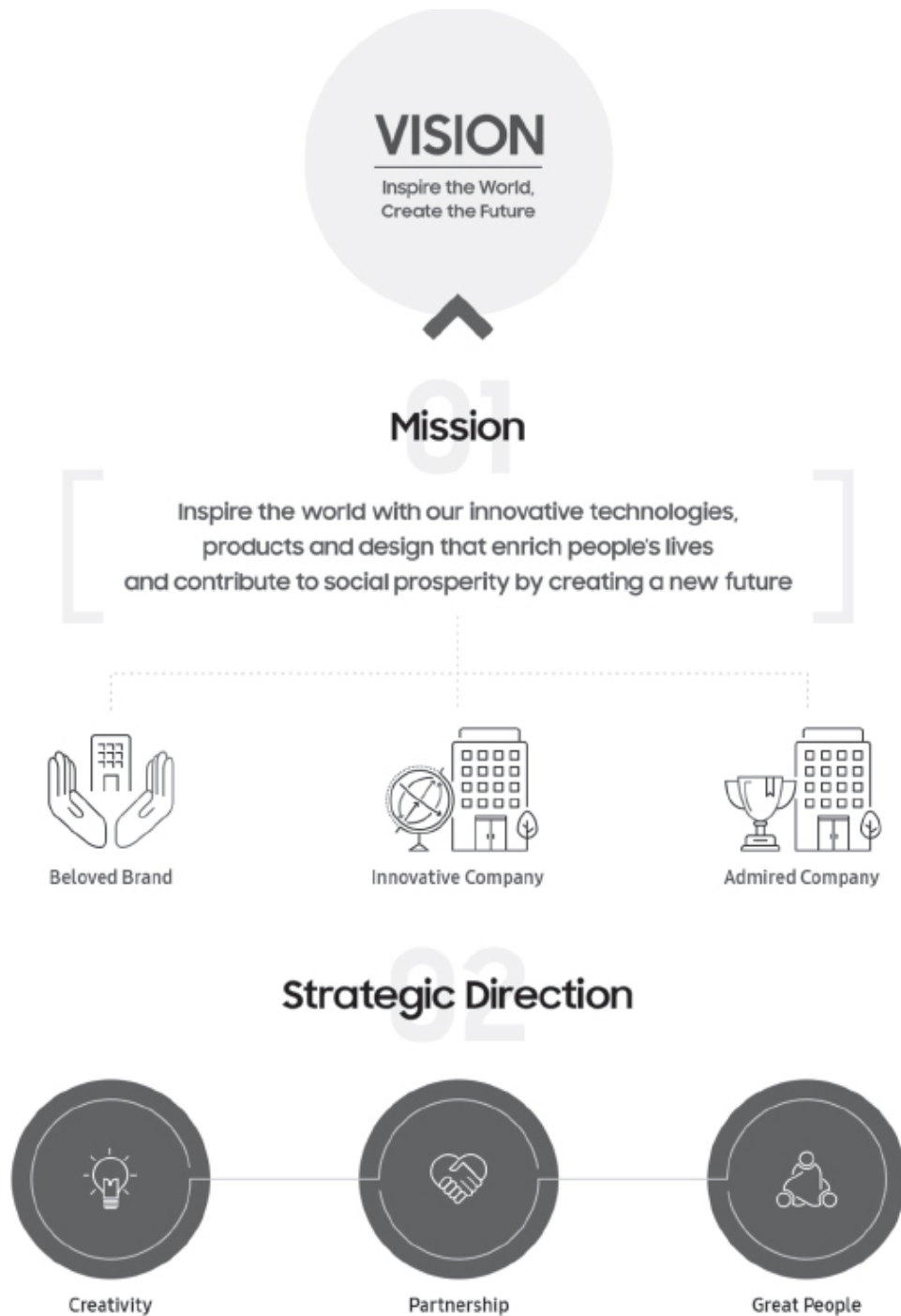
STRATEGY IN ACTION: Samsung – a clear strategic direction⁴²



You may ask yourself if all organisations require a clear strategic direction. What about organisations building their competitive advantage on digital success? In these organisations it seems that technology may be the key driver to success, so which would be more important: innovation or strategy?

The 2015 Digital Business Global Executive Study and Research Project by MIT Sloan Management Review and Deloitte identifies strategy as the key driver in the digital arena. Findings from this study indicate that 'maturing digital businesses are focused on integrating digital technologies, such as social, mobile, analytics and cloud, in the service of transforming how their businesses work'. This study also suggests that the ability to digitally reimagine the business is determined in large part by a clear strategy supported by leaders who foster a culture able to change and invent the new.⁴³

Let us consider Samsung, a world leader in consumer electronics, information technology, mobile communication and device solutions. This company's success is built on being able to reinvent itself through innovation. At the centre of its operations is a clear strategic direction and guiding philosophy.



‘The Vision 2020 is at the core of our commitment to create a better world full of richer digital experiences, through innovative technology and products.

The goal of the vision is to become a beloved brand, an innovative company, and an admired company. For this, we dedicate our efforts to creativity and innovation, shared value with our partners, and our great people.

We have delivered world best products and services through passion for innovation and optimal operation.

We look forward to exploring new business areas such as healthcare and automotive electronics, and continue our journey through history of innovation.

Samsung Electronics will welcome new challenges and opportunities with joy.’

Questions

- Consider Samsung's vision. What do you think are the core values and purpose expressed through this vision
1. (core ideology)?
 2. Do you think the company's core ideology can shape its intended future? Motivate your answer.
 3. How is the core ideology of Samsung expressed in the vision statement?

In the discussion below, we consider how a vision statement relates to a mission statement, their similarities and differences, and how they provide a basis for an organisation's strategy-making process.

3.4 Mission statements

Since the inception of business management as a discipline, scholars have emphasised the importance of formulating a mission statement as one of the fundamental steps in the strategic management process.⁴⁴ A vision statement forms the foundation for an organisation's mission statement, and tends to be enduring, while an organisation's mission statement can change in light of changing environmental conditions.⁴⁵ This makes a mission statement in the current business environment even more important as detailed formal planning is often considered to be problematic in a dynamic and turbulent competitive environment, given that these plans are based on uncertain forecasts. A clearly defined mission statement can give executives the necessary direction to develop strategies in line with changing trends in the form of 'real-time planning'.⁴⁶ A mission statement is thus more concrete than a vision statement, but, similar to a vision statement, it should also establish the organisation's individuality, and should be inspiring and relevant to all stakeholders. Together, the vision and mission statements provide the foundation the organisation needs to choose and implement its strategies.⁴⁷

Many people throughout the organisation representing different salary levels and stakeholders are usually involved in the development of the mission statement. Although it is recommended that just a few people who are part of the mission committee or team be involved in the actual writing of the statement, an organisation should encourage all stakeholders to give input and review drafts. If the organisation follows this process, then everyone has an opportunity to contribute and feel as though they had a voice in the statement's creation.^{48, 49} The sections that follow will consider the formulation of mission statements.

3.4.1 Formulating a mission statement

According to a popular American folk legend, a reporter once asked Abraham Lincoln how long a man's legs should be. Lincoln replied that they should be long enough to reach the ground. This is also true for a mission statement.⁵⁰

Although there is much speculation about the length of such a statement, there is really no clear answer. All that is required is for the statement to convey a clear message in order to reach the target audience. For some organisations, a single sentence is sufficient whilst others produce lengthy documents that include vision statements, values, philosophies, objectives, plans and strategies in supporting roles.⁵¹ Best practice suggests that a statement should be long enough to describe an organisation's objectives in adequate detail, and short enough so that stakeholders can read, understand and use it. In general, the aim should be for a statement to fit on one page. It is, however, not necessary, as some suggest, for it to be short enough for everyone to memorise and recite it.⁵²

A good mission statement should describe the fundamental objectives of the business and should include what people variously refer to as guiding principles, credos or corporate philosophies.⁵³ Typically, a mission statement answers one or more of the following questions:⁵⁴

- *Why is this organisation in business?* The business activity is an indispensable component of a mission statement. It comprises an organisation's basic product or service, the primary market it serves, and the principal technology used for production or delivery.⁵⁵ You would typically find that smaller or less diversified organisations would formulate their mission statements around business activities. More global brands that represent a range of diverse products and/or services would find it more challenging to define their business activities within the scope of a mission statement. Some global brands simply go back to the basics. Consider the mission statement of Google as an example: 'Organise the world's information and make it universally accessible and useful.'⁵⁶ On the surface, this statement appears to be simplistic, but it clearly expresses the purpose of the company.
- *What are our economic goals?* Three economic goals, namely survival, growth and profitability, guide the strategic direction of almost every organisation. The mission statement, either implicitly or explicitly, reflects the organisation's intention to secure survival through growth and profitability. The mission statement of The Walt Disney Company is 'to entertain, inform and inspire people around the globe through the power of unparalleled storytelling, reflecting iconic brands, creative minds and innovative technologies that make ours the world's premier entertainment company.'⁵⁷ This statement explicitly indicates that the company seeks to offer 'profitable experiences'.
- *What is our operating philosophy in terms of quality, organisational image and self-concept?* Operating philosophy in terms of quality considers an organisation's stance towards excellence. Organisational image and self-concept relate to an organisation's 'personality'. This organisational personality extends to the personalities of its members when guiding staff behaviour during working hours. In most cases, 'the organisation's self-concept per se does not appear in mission statements. Yet such statements often provide strong impressions of the organisation self-concept.'⁵⁸ The Walt Disney Company's mission statement clearly expresses its stance towards excellence, i.e. 'to entertain, inform and inspire people around the globe through the power of unparalleled storytelling, reflecting iconic brands, creative minds and innovative technologies that make ours the world's premier entertainment company.'⁵⁹ Coca-Cola's mission statement clearly indicates their self-concept of making a difference, i.e.:
 - » To refresh the world ...
 - » To inspire moments of optimism and happiness ...
 - » To create value and make a difference.⁶⁰
- *What are our core competencies and competitive advantage?* Mission statements may be used to position organisations in terms of value offered, such as cost or differentiation. An example of an organisation that conveys its core competencies in its mission statement is PEP. Their mission statement is: 'We are the friendliest and most trusted retailer, offering wanted products and services at the lowest prices.'⁶¹
- *What customers do and can we serve?* Specific target markets may be included in the mission statement. If you review the examples listed in the Case example box on page 88, you will note that global brands typically consider customers beyond borders and industries. Other mission statements are quite concise to convey a specific target market. Consider, for example, the mission statement of First Descents: 'First Descents provides life-changing outdoor adventures for young adults (aged 18–39) impacted by cancer.'⁶²
- *How do we view our responsibilities to shareholders, employees, communities, the environment, social issues and competitors?* Mission statements frequently include primary stakeholder groups (i.e. customers, employees and the community), communicate the organisation's social responsibility, and emphasise the organisation's commitment to stakeholders.⁶³ Microsoft's mission statement conveys quite an ambitious responsibility: 'Our mission is to empower every person and every organisation on the planet to achieve more.'⁶⁴

Analysing 798 mission statements across industries, Allison found that statements could be grouped into three categories.⁶⁵ Those statements concentrating on a product or service being provided by an organisation fell within the producer category. Mission statements that emphasise working with customers to provide mutually beneficial solutions and experiences were classified in the partner category. Lastly, the promotor category contained statements that suggest that the organisation not only works with the client or customer, but also seeks to improve the quality of life.⁶⁶ We will consider the content of the mission statements of five of the top global brands in the Case example on the next page.

It is interesting to note that these matured brands mostly use shorter statements. The content differed for each organisation and either focused on the business activity or conveyed an ambitious aspiration with a global impact. The next section considers how South African organisations utilise vision and mission statements.

3.4.2 Adoption and practice of vision and mission statements in the South African business environment

Van der Walt, Kroon and Fourie⁶⁷ found that ‘very little research’ has been done in South Africa on the importance and application of vision and mission statements. As a result, they conducted an exploratory study to determine to what extent small, medium and large businesses in South Africa have existing vision and mission statements, as well as the role thereof in the organisation. Although this study was conducted in 2004 and limited to manufacturing businesses in the greater Pretoria area, it still provides valuable insight indicating tendencies regarding the role of vision and mission statements in manufacturing businesses. Results revealed the following:⁶⁸

- Most of the respondents indicated that their business had both mission and vision statements (90% of the respondents) or that they were in the process of formulating them (5% of the respondents).
- ‘The vision and mission statements of the businesses in this study were relatively short, and in most cases one paragraph.’⁶⁹
- The vision and mission statements were generally not older than five years, indicating continuous renewal.
- It appeared that vision and mission statements were used as a strategic planning tool. In most cases, respondents used these tools to assist in strategy formulation, the formulation of goals and objectives, and in strategy implementation.

The next section takes a closer look at value statements and how they relate to mission statements.

CASE EXAMPLE: Mission statements: Considering the content from top global brands

Organisation	Mission	Content	
Google	https://www.google.com/search/howsearchworks/mission/ Classification: Producer category mission statement	Business activity	✓
		Economic goals	✗
		Organisation philosophy	✗
		Competitive advantage	✗
		Organisation self-concept	✗
		Primary stakeholders	✓

		Primary stakeholders	
Microsoft	https://www.microsoft.com/en-us/about Classification: Promoter category mission statement	Business activity	X
		Economic goals	X
		Organisation philosophy	X
		Competitive advantage	X
		Organisation self-concept	✓
		Primary stakeholders	✓
Facebook	Ghttps://www.facebook.com/notes/mark-zuckerberg/bringing-the-world-closer-together/10154944663901634/ Classification: Partner category mission statement	Business activity	✓
		Economic goals	X
		Organisation philosophy	X
		Competitive advantage	X
		Organisation self-concept	✓
		Primary stakeholders	✓
Coca-Cola	https://www.coca-colacompany.com/our-company/mission-vision-values Classification: Promoter category mission statement	Business activity	X
		Economic goals	X
		Organisation philosophy	X
		Competitive advantage	X
		Organisation self-concept	✓
		Primary stakeholders	X
The Walt Disney Company	https://www.thewaltdisneycompany.com/about/ Classification: Producer category mission statement	Business activity	✓
		Economic goals	✓
		Organisation philosophy	✓
		Public image	✓
		Organisation self-concept	✓
		Primary stakeholders	X

3.5 Value statements

A value statement or statement of an organisation's philosophy or creed usually accompanies or appears in the mission statement. 'It reflects or specifies the basic beliefs, values, aspirations, and philosophical priorities to which strategic decision-makers are committed in managing the organisation.'⁷⁰ Given the diverse backgrounds of members of staff, it is important to agree on a set of values that will guide staff behaviour during working hours. These values should then be internalised and used as decision criteria. When people share the same values, this builds quality in the organisation, and if such 'values are agreed upon, it does away with the need to monitor and control'.⁷¹ The importance of organisational values is discussed in [Chapter 13 \(section 13.3.8.3\)](#) where it is noted that organisation's values may contribute significantly to its success.

CASE EXAMPLE: King Price: Our flawsome family and the values we live by⁷²

King Price, like many other organisations, opted not to have formal statements but rather express who they are and what they intend to achieve through the organisation's values. They consider staff members to be part of their family. To guide them, they recognise that rules could help. However, if you read the Opening case study, you would have realised that they do not like rules and hence prefer the term 'values'. That said, they take these rules very seriously and consider them to be more than 'just a bunch of words'. At King Price, their values serve as a 'guide to loving what we do and doing what we love'. Note the tone of how each value is described in the following graphic.⁷³ This informal, playful description expresses the essence of the organisational culture.

		
Yeah, yeah... Everyone says this. But we believe it and we live it. We treat all our clients like royalty ... Because you are. We started off by promising royal service and we delivered. Really, we've won stuff for our royal service. We take service seriously. Your wish is our command.	We believe that a fun workplace = a happy workplace, and that happy staff = happy clients. It's that simple! Look, we work really (really, really) hard but, if we're not having fun while we're doing it, we're doing something wrong. Because smiles are contagious... And we really want to make you smile.	We don't think that anyone ever made a difference by playing it safe. So, we encourage our staff to find new and better ways to do, well, pretty much everything! And the rewards are real. For them, for us, and for you... Because everything we do differently means better cover and bigger savings for you.
		
We look after our cents so that we can pass real Rand savings on to our clients. We're efficient, we find	We aren't just another insurance company... We're a family. A bright, talented, passionate,	We like our people the same way you like your royal savings ... Real. We wouldn't have hired them

solutions fast, and we do things right the first time round. We innovate, we improve, we adapt. And we don't waste talent or time... Because it all adds up to us being the king of price.

committed, happy family. We put our heads, hands and hearts together and make things happen. We've even heard it said that we make magic happen... But we don't really like to boast.

if we didn't think they're all special to start with ... But mostly, we love them because they're one-of-a-kind. We do all we can to ensure that they like what they see when they look in the mirror... Because we sure do!



Our business is insurance but we're also in the business of making a difference. We don't just do it for profit. We are here to change the world... For our clients, our country and our staff. We are all about paying it forward. We are here to leave a legacy... And have fun while we do it.

The value statement needs to clearly state how managers and employees should conduct themselves. It should also provide guidelines as to how business is done in the organisation and paint a picture about the kind of organisation that is needed to realise the vision and mission. 'Insofar as they help drive and shape behavior within a company, values are commonly seen as the bedrock of a company's organisational culture: the set of values, norms, and standards that control how employees work to achieve an organisation's mission and goals.'⁷⁴ The Case example above illustrates King Price's organisational approach to guide behaviours.

The discussion above focused on the tools an organisation uses, namely strategic intent, and vision, mission and value statements, to achieve its strategic direction. We will now discuss the benefits that a clear strategic direction holds for an organisation, and the challenges involved in using these tools to create a clear strategic direction.

3.6 Benefits of clear strategic direction

Literature on vision and mission statements amply demonstrates the value of vision and other guiding principles. The benefits of a clear strategic direction as encapsulated by vision and mission statements are summarised as follows:^{75, 76, 77, 78}

- It guides human behaviour and defines working relationships.
- It helps to shape employee relationships with each other and the external public or stakeholders, especially with customers.
- It can lead to better performance by aiding strategy formulation and implementation.
- It serves as a benchmark for resource allocation.

- It creates confidence that the intended strategies will not compromise the interests of the various stakeholder groups in the organisation.
- It can inspire employees throughout the organisation and remind them of the purpose of the organisation and each individual's role in achieving its goals.

3.7 Challenges of creating a clear strategic direction

A contrarian belief holds that vision and mission statements have little tangible value. This school of thought argues that vision and mission statements are nothing more than a fad and an attempt at window dressing. In some instances, this is true if:⁷⁹

- the vision and mission statements are not accompanied by corresponding manager behaviour
- the articulated thoughts are not communicated to stakeholders and there is lack of buy-in
- the statements do not produce results unless coupled with an overall strategic education process.

To address these challenges, strategic direction should be translated into operational objectives that enable all members of staff to understand their role in the bigger picture. This is discussed below.

3.8 Translating strategic direction into operational terms

It is often difficult to translate strategic direction into operational terms that provide useful guidelines at an operational level. Lofty statements about becoming 'best in class' or being an 'empowered organisation' make impressive reading material, but employees may find it difficult to translate them into operational terms. For people to embrace and act on the words in vision, mission and value statements, those statements should be expressed and communicated as an integrated set of objectives and measures that describe the long-term drivers of success.⁸⁰ These objectives need to set clear guidelines and identify the individuals who will be responsible to implement the strategies. In addition, it is necessary to state by what time the work needs to be completed as well as the resources required to do it. Well-stated objectives are thus quantifiable, or measurable, and contain a deadline for achievement. In reality, the aspects required to be addressed in objectives will be determined by the way in which the strategies have been developed, as reviewed in [Chapter 1](#). In this sense, the strategy development phase and the strategy implementation phase are interconnected.⁸¹

In essence, the managerial purpose of setting objectives is to convert the strategic direction into specific performance targets. These targets could relate to financial or strategic objectives, and time periods associated with the delivery of performance could be short-term or long-term. Financial objectives communicate management's targets for financial performance such as revenue growth, profitability or return on investment. Financial performance measures are often lagging indicators that reflect the results of previous strategic and operational decisions. In comparison, strategic objectives essentially relate to how an organisation envisages creating a sustainable competitive advantage and also deals with the future marketing standing. Strategic outcomes are leading indicators and project a company's future financial performance and business prospects. The accomplishment of strategic objectives signals the company is well positioned to sustain or improve its performance.⁸²

It is important to strike an optimum balance between financial and strategic objectives to ensure both survival and profitability in the long term. Organisations often use the balanced scorecard (discussed below) as a means of translating strategic direction into operational objectives that deal with survival, growth and profitability.

3.9 Balanced scorecard

A **balanced scorecard** is a strategic management tool that is useful for guiding, controlling and challenging an organisation towards realising a shared conception of the future. Kaplan and Norton developed the balanced scorecard in the early 1990s to extend the primary focus on short-term financial performance to include long-term strategic dimensions that deal with delivering results. The balanced scorecard enables organisations to achieve an integrated, aligned and balanced focus on four perspectives that collectively underpin the achievement of the organisational vision.⁸³ These perspectives are the following:^{84, 85}

- *Financial perspective*: This perspective is based on financial performance that provides the ultimate definition of an organisation's success. As it is the objective of every organisation to deliver maximum value to stakeholders, the question asked here is: 'How do we appear to our stakeholders?'
- *Customer perspective*: To survive and grow, organisations must be able to deliver quality goods and/or services that will satisfy customers' needs. The question asked is: 'How do we appear to our customers?' Indicators of customer success include measures such as satisfaction, retention and growth.
- *Internal business processes*: The question here is: 'What must we excel at?' Identifying the key business processes at which an organisation must excel to meet strategic goals and customer expectations can lead to subsequent improvements in customer and financial outcomes.
- *Learning and growth perspectives*: Learning and growth perspectives describe how people, technology and the organisational climate can be combined to support the strategy. This perspective focuses on the root causes of competitive sustainability, and asks the question: 'How can we continue to improve and create value?'

These perspectives offer a balance between financial and non-financial measures used to develop a framework and a focus for many critical management decisions. The application of this tool is thus useful throughout the strategic management process. During the planning phase, the balance scorecard is used to align strategic direction with long-term objectives that express the organisation's desired business strategy. The tool is used during the implementation phase to set departmental and individual goals; to communicate the strategy throughout the business; for business planning; to allocate capital; and to identify strategic initiatives.⁸⁶ Finally, the tool is used during the control phase to measure whether objectives were achieved and to provide feedback and learning. The discussion to follow considers the development of the scorecard, and focuses on the processes used to align strategic direction with short-term actions required during the implementation phase. [Chapter 14](#) expands on this concept to provide an overview of how an organisation can use the balanced scorecard to measure performance.

To capture the organisation's desired business strategy, the balanced scorecard uses four processes, namely clarifying and translating the vision into strategy; communicating and linking strategic objectives and measures; planning, setting targets and aligning strategic initiatives; and enhancing strategic feedback and learning.⁸⁷

3.9.1 Clarifying and translating vision into strategy

A gap often exists between the vision and mission statements and employees' knowing how their day-to-day actions could contribute to realising the organisation's strategy. Senior executives may also agree on the words used to express the strategic statements, yet each person may interpret the terminology differently. For example, if you were to ask four executives to define superior service, you are likely to receive four different definitions. This difference of opinion escalates when you repeat the exercise with lower management.⁸⁸ Translating the vision into a set of objectives and measures helps managers build consensus on the organisation's vision and strategy.

The perspectives of the balanced scorecard require the executives to clarify the meaning of the strategy statement by developing operational measures for the four scorecard perspectives, i.e. financial, customers, internal business processes, and learning and growth. The executives must state in specific terms the 'definition of success' in each of these areas as well as their relative importance weightings. The translation of their vision into terms that have

meaning to the employees who must realise the strategy will enable the employees to embrace these requirements in their day-to-day activities.⁸⁹ In addition, the scorecard also highlights gaps in employees' skills and other resources required to pursue long-term objectives.⁹⁰ See the Case example on page 95 for an illustration of a typical balanced scorecard suitable for a bank. This scorecard should be read from right to left to understand the means employed to reach the desired end goal.

3.9.2 Communicating and linking strategic objectives and measures

The second process, communicating and linking, allows managers to communicate their strategy throughout the organisation, and to link it to departmental and individual objectives. To do this, scorecard users generally engage in three activities, namely communicating and educating, setting goals and linking rewards to performance measures.⁹¹

CASE EXAMPLE: The Balanced Scorecard Institute

The Balanced Scorecard Institute (BSI) provides comprehensive resources online that include examples of scorecards, articles and videos. The company also provides consulting and training for this tool. You can view examples of how organisations, governments and non-profit organisations worldwide developed their own scorecards at: <http://www.balancedscorecard.org/BSC-Basics/Examples-Success-Stories>

To implement a strategy successfully, it is essential to communicate with and educate the employees who have to execute it. The management team can use a broad-based communication programme to share the strategy with all employees, as well as the critical objectives they have to meet if they want to implement the strategy successfully. Mere awareness of corporate goals is, however, not enough to change many people's behaviour. High-level strategic objectives and measures must be translated into objectives and measures for operating units and individuals. To accommodate this, the scorecard contains three levels of information.

- The first level describes corporate objectives, measures and targets.
- The second level allows corporate targets to be translated into targets for each business unit.
- The third level converts business units and corporate objectives to individual and team objectives that set targets for each measure and allow up to five performance measures per objective.⁹²

The balanced scorecard approach links employee rewards to performance in all four areas, with suitable weightings applied to reflect the relative importance of each one.⁹³

3.9.3 Planning, setting targets and aligning strategic initiatives

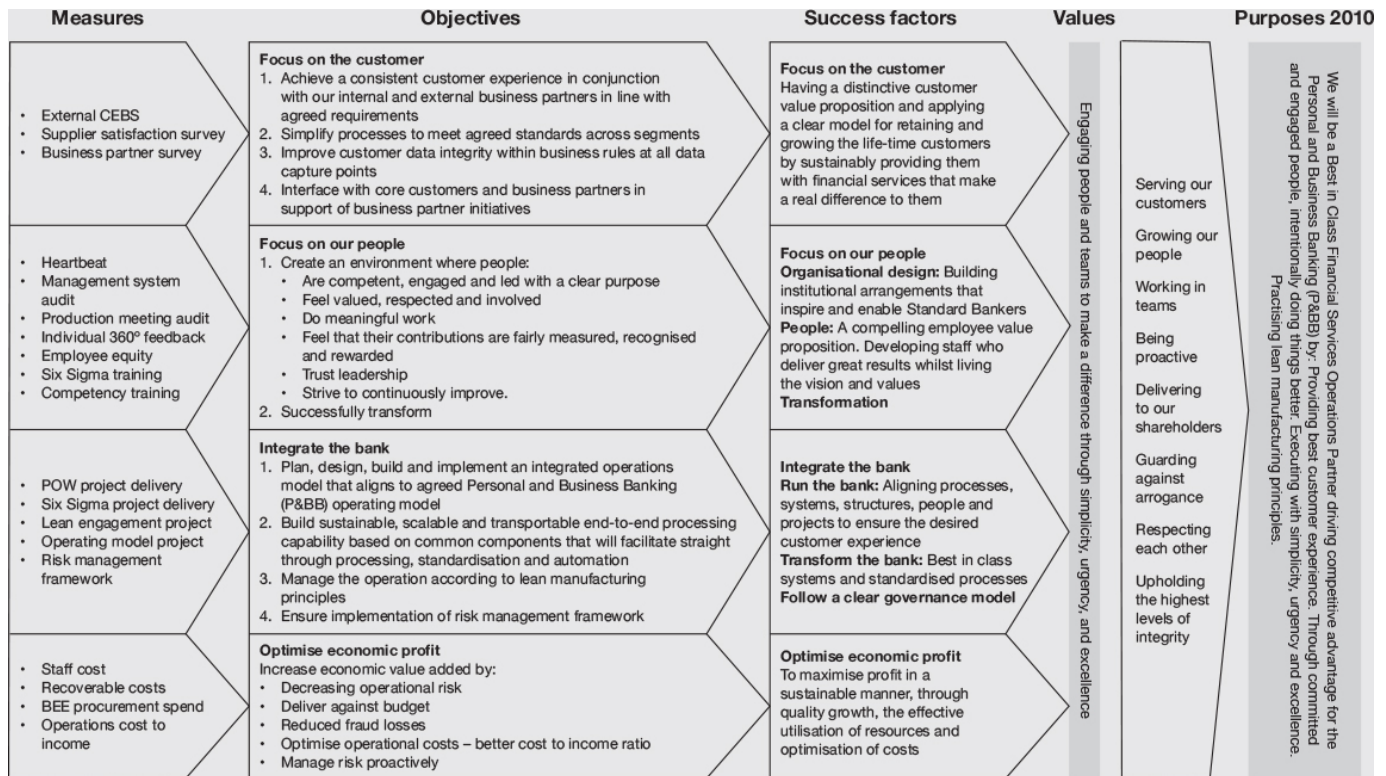
Many organisations have separate procedures and organisational units for strategic planning, resource allocation and budgeting. Often, senior management is responsible for formulating the strategic plan, while the financial department conducts a separate resource allocation and budgeting process to set financial targets for revenues, expenses, profits and investments for the next fiscal year. The result is that the budget produced generally bears little relation to the targets in the strategic plan, resulting in conflicting priorities and reporting. A balanced scorecard forces an organisation to integrate its strategic planning and budgeting processes, and therefore helps to ensure that the budgets support its strategies. Building a scorecard thus enables an organisation to link its financial budgets with its strategic goals. The scorecard measures can also be used as the basis for allocating resources and setting priorities by prioritising initiatives according to their contribution towards the long-term strategic objectives.⁹⁴

3.9.4 Enhancing strategic feedback and learning

In the contemporary business environment, strategies may lose their validity as business conditions change. However, if management systems are built on the principles of a balanced scorecard, organisations can monitor short-term results from four different perspectives to evaluate strategies in the light of recent performance.⁹⁵ 'The scorecard thus enables companies to modify strategies to reflect real-time learning.'⁹⁶ Feedback and learning often stimulate executives to learn about the vitality of their strategy, resulting in what we call strategic learning. Strategic learning occurs when feedback is used to test the assumptions on which the strategy was based. Executives then use the findings to make the necessary adjustments. The balanced scorecard therefore 'provides a framework for managing the implementation of strategy while also allowing the strategy itself to evolve in response to changes in the organisation's competitive, market and technological environments.'⁹⁷

CASE EXAMPLE: Standard Bank: Example of a balanced scorecard⁹⁸

Figure 3.1 Standard Bank's balanced scorecard



3.10 Summary

This chapter looked at the strategic tools organisations employ to set their strategic direction. The tools considered in this chapter include strategic intent, vision statements, mission statements, value statements and balanced scorecards. Setting the strategic direction is an important first step in strategic planning and management as it informs and shapes how an organisation defines itself, and where it finds its unique strategic advantage. By creating

a 'bigger picture', it also motivates and challenges organisational members to go beyond the status quo in pursuit of a long-term quest.

The process of creating strategic direction is a creative process. Although various guidelines exist, organisations generally apply an individual approach suited to their operational requirements. The strategic leader plays an important role in setting the strategic direction, and is responsible for generating excitement about the future of the organisation and for inviting organisational members to help crystallise that vision. Leaders are expected to walk the talk, and their behaviour and conduct should embody the core values of the organisation. Finally, the executive team should communicate the strategic direction to all stakeholders. Statements should be clear or, alternatively, be decoded or translated into meaningful parts. Organisations can do this by applying the balanced scorecard tool.

REFLECTION BOX:

If someone asks you for directions, what use would a map be without the coordinates of the starting point or destination? A clear strategic direction provides the coordinates that are required to reach a destination. The mission is the starting point and the vision the destination. The itinerary and route are determined by the strategic intent, and the group of travellers are described by the value statement. Similar to a traveller, companies will get lost if they do not have the tools to navigate their movements.

Opening case study questions

1. How did the vision of King Price shape the strategic actions of the company?
2. Comment on the alignment between the company's name, the vision of the founder and the business model.
3. Why is the development of a clear strategic direction important for the future success of an organisation?

Discussion questions

1. Explain why strategic intent might be regarded as the first indispensable step in the strategic planning or management process.
2. Expound on the similarities and differences between strategic intent and vision statements.
3. Discuss the key elements of a mission statement.
4. Distinguish between strategic and financial objectives, and comment on why it is important to develop both types of objectives to achieve long-term survival and profitability.
5. Explain the role of the balanced scorecard in setting strategic direction.
6. Explain the link between an organisation's strategic direction and its strategy.
7. How can strategic direction be translated into operational terms?

Using knowledge and skills

Use your critical abilities to analyse the strategic direction of any three listed organisations operating in the same industry. Comment on the following aspects:

1. Which tools are used to convey strategic direction?
2. Describe the essence of each company's strategic direction.
3. Compare the length and scope of each statement used to support the strategic direction.
4. Summarise the key differences between the selected companies, and indicate which approach you prefer. Motivate why you prefer the selected approach.

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Suggested websites

- About.Com Human Resources (http://humanresources.about.com/od/success/qt/values_s7.htm) – Read more about how to identify and live your personal values.
- HubSpot (https://offers.hubspot.com/define-mission-and-vision-statements?hubs_post-cta=author&hubs_post=blog.hubspot.com/marketing/inspiring-company-mission-statements&_ga=2.12108787.69083938.1534404841-2030258184.1534404841) – Free online course that teaches you how to define inspiring mission and vision statements.
- Mission statements.com (<http://www.missionstatements.com/>) – Ideas and inspiration for defining your own mission statement.
- SmartDraw Communicate Visually (<http://www.smartdraw.com/specials/ppc/balanced-scorecard-software.htm?id=62353&gclid=CL3UxZjjj6ACFUYB4wodiSdYdA>) – Create a balanced scorecard, or any other type of business graphic, in minutes with SmartDraw.
- Vision Statements (<http://www.samples-help.org.uk/mission-statements/vision-statements.htm>) – A resource centre with all the need-to-know information about vision statements.
- The Balanced Scorecard Institute (BSI) (<http://www.balancedscorecard.org/BSC-Basics/Examples-Success-Stories>) – The BSI provides comprehensive resources online that include examples of scorecards, articles and videos. The company also provides consulting and training on this tool. You can view examples of how organisations, governments and non-profit organisations worldwide developed their own scorecards.

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PART TWO

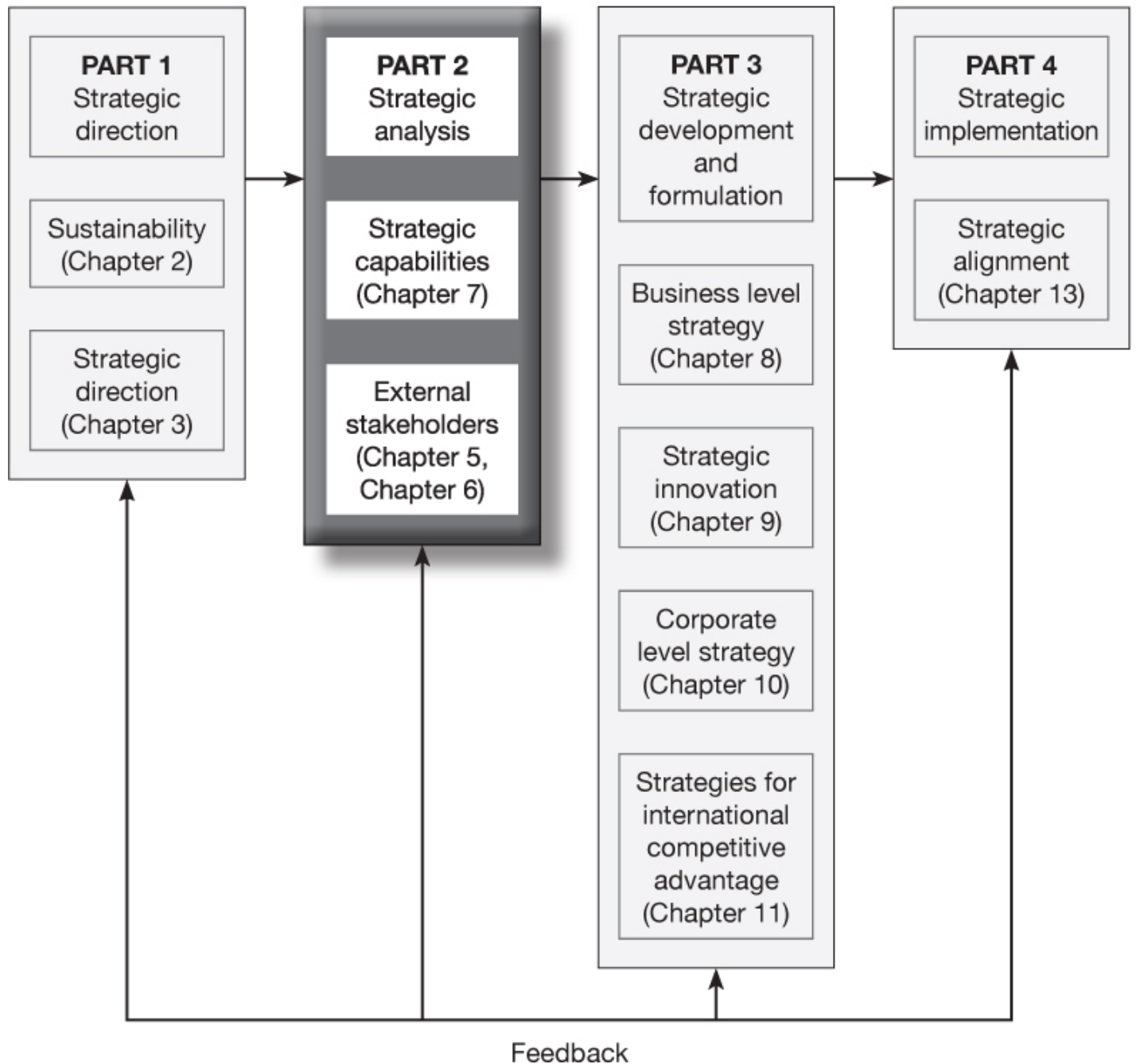
Strategic analysis

THE ORGANISATION'S STRATEGIC CONTEXT

Strategic
decision-
making
(Chapter 4)

Strategic
leadership
(Chapter 12)

Strategic risk
management
(Chapter 14)



CHAPTER 4

Strategic decision-making

Peet Venter

LEARNING OUTCOMES

After reading this chapter, you should be able to:

- describe the nature of strategic decision-making
- explain how strategic decisions are made
- identify the contextual influences and their effect on strategic decisions
- distinguish between the different strategic decision enablers
- Identify ways of improving the quality of strategic decision-making
- critically evaluate strategic decision-making in your own and other organisations.

KEY TERMS

big data analytics
bounded rationality
competitive intelligence
decision criteria
environmental scanning
geographic focus
horizontal focus
integrating mechanisms
satisfice
scope of the organisation
strategic decision enabler
strategic decisions
vertical focus

OPENING CASE STUDY



Telkom's lesson in strategic decision-making: The Multi-Links disaster¹

In May 2007 Telkom acquired 75% of Multi-Links, a private Nigerian telecommunications operator with a Universal Access Licence that allowed it to provide fixed, mobile, fixed-wireless, international and data services in one of the fastest-growing telecommunications markets in Africa. It also owned an internet service provider (ISP) licence. Multi-Links was Nigeria's pioneer national private telecommunications operator (PTO) and was the first telecommunications operator in Nigeria to introduce Code Division Multiple Access (CDMA) technology, a digital fixed-mobile technology that enables the provision of more efficient and cost-effective wireless solutions. The company's performance following the acquisition was impressive, with its customer base growing from 262 431 to more than 1.7 million subscribers at the end of September. Multi-Links also effected network and capacity improvements to bolster their ability to provide quality data products, especially to the corporate market.

In 2009, Telkom announced that it had acquired the remaining 25% ownership of Multi-Links for \$130 million, which Telkom maintained met its broader investment criteria and expanded its mobile capacity, an area that Telkom was keen to invest in after it sold off its share in Vodacom in 2009. According to Telkom's CEO at the time, Reuben September, the deal advanced Telkom's goal of becoming Africa's leading ICT solutions provider, and demonstrated Telkom's determination to expand domestically as well as beyond South Africa's borders into areas of growth, healthy returns and value creation for the company's shareholders. 'We remain focused on pursuing growth by diversifying our revenue streams into African markets with high growth potential,' stated September.

Just two years later, Telkom's proud acquisition turned into a problem child and became the telecom operator's biggest investment mistake, costing Telkom R5.1bn in impairment losses of an initial investment of about R2.8bn.

In addition, Telkom was also facing a lawsuit and arbitration case which seemed likely to lead to further impairment losses. Blue Label Telecoms was suing to recover an unspecified amount of damages after losing an exclusive contract with Multi-Links, while private-equity group Helios Investment Partners and SA's Shanduka Group filed a lawsuit to recover R1.8 billion, claiming Telkom walked away from a 10-year rental agreement after just three years.

Where did Multi-Links go wrong?

Poor market research, over-eager investing and weak leadership were believed to have led to the downward spiral of Multi-Links, with analysts citing the following more specific reasons for the disaster:

- Telkom invested in CDMA (Code Division Multiple Access) network technology that does not have much of a future in Africa – GSM (Global System for Mobile communications) network technology is far more popular and more in demand on the continent.
- Telkom appears to have over-invested in Multi-Links, paying far too much for the remaining 25% of the company. In 2007, 75% of the company cost Telkom \$280m and two years later it spent an additional \$130m on the remaining 25%.
- Telkom also did not understand the market dynamics in Nigeria, a mistake that was ostensibly due to a lack of proper market research. For example, they appeared to underestimate the competitiveness of the Nigerian market, and the increased competition (four well-entrenched and about six other mobile operators in Nigeria at the time) made it very difficult for Telkom to compete.

Telkom was struggling to diversify its revenue stream, and while Multi-Links was meant to be the start of its diversification, it failed horribly, costing Telkom an estimated R10bn in impairments. The only hope is that Telkom learnt some valuable lessons from its costly mistake.

Overview

Strategic decisions are the fundamental, significant decisions that shape the course of an organisation.² They are complex and, as we can see from our Opening case study, getting it wrong can be extremely costly. Strategic decision-making is the cornerstone of strategic management and sustainability. In this chapter, we examine strategic decision-making and its enablers. Most strategic management books emphasise the importance of external and internal environmental analysis in support of strategic decision-making, but few recognise the importance of having

an infrastructure in place to support such decision-making. In its ideal form, this infrastructure is a complex network of people, processes and technology that processes intelligence and produces insights in a form that adds value by supporting strategic decision-making. This chapter also introduces you to these strategic decision enablers as a prerequisite for having effective environmental scanning and analysis processes. This chapter should ideally be read in conjunction with [Chapters 5 to 7](#), where we address the theoretical aspects of the macro-, industry and internal environments, respectively.

4.1 Introduction

In the Opening case study the strategic value of good information is emphasised. After all, those organisations that can sense environmental changes and adapt to them in time ultimately have the best chance of survival and of leading their industries. In strategic management, the value of scanning and analysing the internal and external environment is clearly established. However, its relationship with strategic decision-making is not as well understood. In order to explore this phenomenon, we will first outline the nature of [strategic decisions](#). While organisations may differ greatly in how they make strategic decisions, there are some common elements of strategic decision-making.

Strategic decisions are big decisions, typically affecting the whole organisation, and are not limited to a specific function or department. In addition, they require massive investments of resources that, once committed, cannot be easily reversed, and failure has severely negative implications. In the Opening case study we can see that Telkom's Multi-Links failure cost them billions of rands, not to mention the impact on their market capitalisation and reputation.

Strategic decisions are more often than not the result of cooperation between many different people and are accordingly a collective effort, often with many participants inside and outside of the organisation. Only in the very smallest of organisations might we find that strategic decisions are made by a single individual. In other words, we can usually refer to a decision team – a group of people who are involved with the strategic decisions within an organisation. In the case of Telkom, this team could have comprised of the CEO and his or her top management team, the board, internal support structures (e.g. the corporate finance team) and external consultants to conduct due diligence and establish the purchase price.

Strategic decisions are about change in the long run. They are future oriented and concern the long-term direction and success of the organisation, so they can never be regarded as routine decisions. Strategic decisions are typically about changes to the **scope of the organisation** in terms of its vertical, horizontal or geographic focus. The **horizontal focus** of the organisation refers to the breadth of the product and service range offered by the organisation. The [vertical focus](#) refers to the phases in the industry value chain that the organisation is active in, whereas the **geographic focus** refers to the geographic scope of the organisation, for example national, regional or global.

The problems and opportunities addressed by strategic decisions are complex, and their outcomes are uncertain. For this reason, strategic decisions are risky. Despite Telkom's initial confidence in their decision to acquire Multi-Links, things went wrong rather quickly.

[Strategic decisions](#) seek to create consistency (fit) between the organisation and its internal and external environments. For that reason, they are heavily dependent on good strategic information and analysis. However, they are also dependent on the innovation and creativity of both individuals and teams. As such, it is often said that strategy (and by extension, strategic decision-making) is both art and science. To this we can add that it is also heavily influenced by the expectations and power of diverse stakeholders and is not a purely rational and cognitive process.

Strategic decision-making is context dependent and is influenced by the characteristics of the decision team and the individuals in it, the nature of the decision itself and the circumstances under which it is made, the

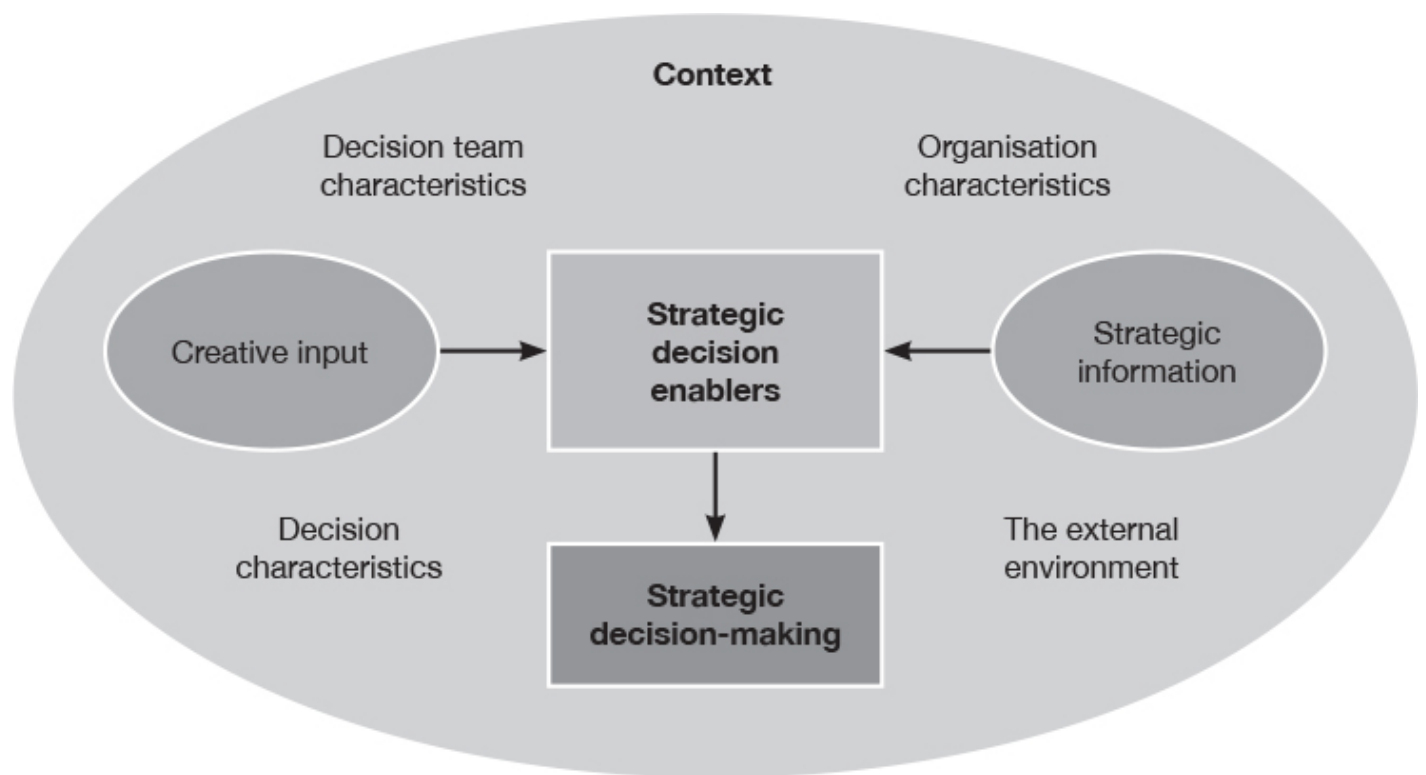
characteristics of the organisation itself, and the external environment.³

Figure 4.1 is a diagrammatic depiction of the nature of strategic decision-making. Strategic decision-making takes place in a specific context (section 4.3), which influences how the decision is made and what decision is made. Both creative input and strategic information are required for strategic decision-making. The strategic decision enablers (section 4.4) are comprised of the people (the decision team), processes and technology that, in combination, provide the insight that enables strategic decision-making. In section 4.2 we examine strategic decision-making in more depth.

4.2 How strategic decisions are made

Considering the complexity of strategic decision-making, it is fair to deduce that organisations may differ vastly in how they approach strategic decision-making, what they use as decision criteria, and who is involved in the decision-making process. Despite the tendency to regard strategic decision-making as a rational and cognitive process, it is often far messier than we think. In this section we examine three ways of making strategic decisions, namely a rational, a visionary and an experimental approach.⁴

Figure 4.1 The nature of strategic decision-making



4.2.1 Strategic decision-making as a rational process

Strategic decision-making is often described as a rational, linear and cognitive process. A typical process approach to strategic decision-making may go as follows:

- The organisation recognises the need for a strategic decision to be made regarding a problem or opportunity.
- The decision team collects information about the problem or opportunity, which may include, for example, conducting market research, enlisting the help of external consultants, conducting a financial analysis and

developing business cases. This process may be quite time and resource intensive.

- Following information collection and analysis, the decision team identifies a set of alternatives for addressing the problem or opportunity.
- Based on a set of **decision criteria** (e.g. return on investment), the team selects the best alternative. Decision criteria refer to the measures, principles or guidelines used to help the decision team decide. These can be used informally or as a formal scoring system. Decision criteria are specific to the organisation and its context, but may include various aspects such as financial measures (e.g. cost, projected return on investment, lifetime cost of ownership of an asset), the impact on the organisation's performance and sustainability (e.g. time to implement, reliability, risk) and its effect on key stakeholders (e.g. its impact on customer service).
- The selected alternative is then implemented.

Mintzberg and Westley⁵ call this the 'thinking first' approach, and point out that one of the problems with it is that it disregards or even disables the insights that may arise from a more exploratory process that involves discussion, visioning and improvisation. It favours facts and process efficiency, and is accordingly heavily skewed towards the 'science' of strategy.

4.2.2 Strategic decision-making as a visionary process

The 'seeing first' approach, as Mintzberg and Westley refer to it, begins with a vision in mind. The organisation or a strategic leader envisions what can be achieved or where they could be in some point in the future, and strategic decisions are then made with that vision in mind. Elon Musk is an excellent example of a strategic leader who makes strategic decisions based on his vision of the future (see the Case example below).

CASE EXAMPLE: Elon Musk's vision of the future⁶

In 2006, Elon Musk announced in a blog his 'master plan' for sustainable mass transport:

1. Create a low-volume car, which would necessarily be expensive.
2. Use that money to develop a medium-volume car at a lower price.
3. Use that money to create an affordable, high-volume car.
4. Provide solar power.

Musk is known for his vision to rid the world of the use of fossil fuels, and Tesla's electric vehicles and solar power technologies are ways of doing just that. Over the past decade, he introduced the Tesla S, an expensive, high-performing sports car, followed by the Tesla X and Tesla Roadster. The Tesla 3, an affordable electric car, was announced in 2016, and reached advance orders of more than 400 000 cars. Despite problems with implementation, the plan is forging ahead, and the master plan is seemingly on track. In the meantime, Tesla also launched various products for residential and business solar energy production, such as the Powerwall battery system, solar panels and a 'solar roof', and their SolarCity business is now the second largest solar provider in the US. In support of its businesses, Tesla has built a Gigafactory (with Panasonic) for producing lithium-ion batteries for use in battery farms and electric cars.

4.2.3 Strategic decision-making as an experimentation process

Sometimes, strategic decision-makers are faced with choices for which there is no existing precedent, or they are entering new and unfamiliar territories which they are uncertain of how to assess. As a result they cannot clearly envision a decision, and they cannot apply rational decision processes to it. The only option that remains is to act, and to learn from doing what works and what does not work – in other words, to experiment. Mintzberg and

Westley⁷ describe this approach as ‘doing first’. Honda’s entry into the US market is an example of using an experimental approach to strategic decision-making (see the Case example below).

Rather than proposing that one approach is better than the other, strategic decision-makers can use all three methods, often in combination, to improve their decision-making. In the next section, we explore the context of strategic decision-making.

CASE EXAMPLE: Honda in the USA – brilliant strategy or an experiment that worked?⁸

According to Honda managers, they just tried to see if they could sell something in the US, competing with European imports. They knew very little about the American market, and struggled to make inroads initially. The breakthrough Honda needed came about by chance rather than careful planning. While waiting for the engineers to upgrade the engine design of their larger motorcycles, the Honda managers used their small, lightweight bike – the 50cc Super Cub – to run errands. These little motorcycles attracted a lot of attention from the locals to the extent that a buyer from the retailer Sears wanted to place an order with Honda. The Super Cub became an instant hit, especially with young buyers who wanted inexpensive, convenient, individual transportation for short trips around town. The Super Cubs eventually became Honda’s springboard for their success in the American market.

4.3 Contextual influences on strategic decision-making

In the following sections, we focus on the four major contextual influences on strategic decision-making, namely:

- the characteristics of the decision-makers in the form of the decision team and the individuals in it
- the characteristics of the decision and the circumstances under which it is made
- the characteristics of the organisation and the external environment.⁹

4.3.1 The characteristics of the decision-makers

While strategic decisions are most often made in teams, and the characteristics of such teams can impact how strategic decisions are made, those teams are comprised of individuals who also have their own characteristics. We discuss a few of these characteristics, namely bounded rationality, politics and power, and the diversity of the team and their influence on the decision-making process below.

4.3.1.1 Bounded rationality

Bounded rationality refers to the cognitive limitations of managers which result in managers being unable to be fully rational and to consider all available alternatives. The concept was developed by Herbert Simon, who described bounded rationality as follows: ‘... the capacity of the human mind for formulating and solving complex problems is very small compared with the size of the problems whose solution is required for objectively rational behavior in the real world — or even for a reasonable approximation to such objective rationality.’¹⁰ Because human beings and, by extension, managers, do not have limitless cognitive powers, they have limitations in the number of alternative solutions they can consider. In other words, they cannot be fully rational and consider all possible solutions to a problem; their rationality is bounded. Research in this area supports three findings about bounded rationality:¹¹

- Strategic decision-makers have been shown to **satisfice** rather than to optimise. In other words, they may opt for obvious solutions that may address the problem but may not necessarily be the most optimal one. Satisficing is a

combination of the words 'satisfy' and 'suffice' used by Herbert Simon¹² to describe the selection of an alternative in decision-making that is not optimal due to the bounded rationality of the decision-maker. In addition, decision-makers rarely do comprehensive research about the decisions they have to make, and may only discover their goals in the process of searching.

- Strategic decision-makers could be rational in some ways but not in others. In other words, even while rational processes may be followed, emotions and politics may still be involved and influence the final decision.
- Many strategic decisions follow the conventional rational decision process (see [section 4.2.1](#)) at first, but the complexity of the decision, conflict between decision-makers, and time pressure (the amount of time available to make a decision) ultimately determines the decision process. For example, they may cycle through various stages of the decision process (see [section 4.2.1](#)) repeatedly, deviate from it, or even get stuck in some stages.

The decision team is not only characterised by its cognitive limitations, but also by the political influences and power plays within it.

4.3.1.2 Politics and power in strategic decision teams

Human beings are political (tendency to seek power), and the quest for power very often plays out in organisations and in their strategic decision-making processes. Research in this area supports the following findings:¹³

- The members of decision teams will not all have the same preferences. Preferences regarding strategic decisions are very often in conflict.
- Powerful people within the organisation (powerful due to their position within the organisation) very often get what they want, and in strategic decision-making, powerful people may influence the outcomes of decisions.
- Individuals in the decision process will use political tactics such as forming coalitions, using or withholding information, or co-optation to enhance their power and influence on the strategic decision-making process and outcome.

4.3.1.3 The diversity of the decision team

The more similar people are, the less likely they are to come into conflict. Individuals from different backgrounds and different demographic groupings approach things differently, which may lead to more conflict. For these reasons, the diversity of the decision-making team in terms of age, gender, cultural and ethnic background, education, functional area and corporate experience may influence strategic decision-making.

4.3.2 The characteristics of the decision

As we have already seen in the previous section, the characteristics of the decision that must be made can also affect the strategic decision-making process, the time devoted to it and the outcome. The following decision characteristics (as seen from the perspective of the decision-makers) impact on how the decision is made:¹⁴

- The complexity and political importance of the *decision matter* inherent in a strategic decision determine the process by which a decision is made. Political importance in this sense refers to the effect of the strategic decision on the power bases of decision-makers. For example, one could argue that the complexity and implications for the power bases of decision-makers are much higher in the case of a decision to expand the organisation to China than they are for the decision to open another branch in another province. In other words, the complexity of the decision matter of the former is much higher than that of the latter. Power bases could reside in the position the decision-maker holds within the organisation, the support he or she enjoys within it, his or her ability to reward, etc. For example, a labour union will generally oppose retrenchments because this will erode their power base (i.e. their support from workers).

- *Level of uncertainty* concerning the actions that should be taken or the information required to make a decision may cause decision-makers to be more inclined to use political processes, such as bargaining with other decision-makers, rather than gathering and analysing information. For example, when a specific strategic decision is surrounded by uncertainty, certain key decision-makers may support other decision-makers in exchange for something in return (such as their support in another strategic decision). This process of bargaining (or trading off) is a political process rather than a rational one based upon facts.
- The *importance* of the decision for the organisation may result in a more comprehensive approach to decision-making, using financial information, involving management from multiple levels and communicating across functions.
- *Time pressure* may lead to more disagreements, fewer managers being involved and less communication across departments.

In the next section, we consider the organisational characteristics that influence strategic decision-making.

4.3.3 The characteristics of the organisation

Organisational culture, structure and systems will affect how decisions are made and determine to what extent strategic decisions are made using formal processes or organisational power and politics (power plays within the organisation). More specifically, the following characteristics regarding the organisation have been found to influence the strategic decision-making process:¹⁵

- *Power centralisation*: The more power is centralised in the organisation (e.g. an autocratic CEO), the more likely the members of the organisation are to engage in political tactics such as coalition forming to establish their own power bases, which may lead to organisational politics dominating strategic decision-making.
- *Structure*: Informal organisations with fewer rules are more likely to have more flexible decision-making processes and greater participation of multiple different internal stakeholders. Formal organisations, with more rules are more likely to have a formal process for strategic decision-making involving the same small number of individuals.
- *Size*: Large organisations tend to be more comprehensive in their strategic decision-making processes than small ones, meaning that they will gather and analyse more information, do more financial analyses, involve more managers and communicate more across departments.

In addition to the internal environment, strategic decision-making is also influenced by the external business environment of the organisation.

4.3.4 The external environment

It is widely accepted that one of the key tasks of strategic management is to ensure a fit between the organisation and its external environment. It accordingly stands to reason that the external environment, such as the industry of which the organisation forms part, will influence how strategic decisions in the organisation are made. Some of these influences are discussed in more detail below.¹⁶

4.3.4.1 Hostile environments

In hostile and threatening environments, ineffective strategic decisions could have a severely negative effect on the survival of the organisation. Accordingly, it could be expected that strategic decisions should be more comprehensive and make more use of strategic information and analysis.

4.3.4.2 High-velocity, dynamic and unstable environments

High-velocity, dynamic and unstable environments are characterised by quick and unpredictable changes in trading conditions, and high levels of uncertainty. It could thus be argued that such environments require fast yet effective strategic decision-making. A study in the high-velocity micro-computer industry highlighted how successful organisations within this industry used real-time information to simultaneously consider multiple strategic decision alternatives, which allowed them to speed up the decision-making process and therefore make better decisions.¹⁷ Strategic decision-makers are also more likely to focus on the decision and the process, and less likely to become distracted by disagreements and debates. However, there are also some studies that have suggested that rational or comprehensive approaches to strategic decision-making are of limited value due to information that is unavailable, incomplete or quickly outdated.

4.3.4.3 Environmental munificence

Environmental munificence refers to the extent to which the resources required by the organisation to execute its strategic decisions is present (or not) in the environment in which it operates. Empirical evidence is inconclusive but research thus far supports the view that rational strategic decision-making processes lead to more effective strategic decision-making, in environments with both high and low munificence.¹⁸ In other words, research so far suggests that a rational process in terms of strategic decision-making delivers the most effective strategic decisions under all levels of munificence.

4.3.4.4 Environmental uncertainty

In conditions where information can be collected to mitigate the uncertainty (e.g. about customer preferences), a comprehensive strategic decision-making process can lead to higher performance. Where information about an uncertainty is hard to collect (e.g. technological changes), comprehensive strategic decision-making processes are of little value, as we can see in the Case example *Telkom's decision to sell its share in Vodacom*.

In the next section we examine the role of strategic information in strategic decision-making.

4.4 Strategic decision enablers

All strategic management texts highlight the analytical activities associated with obtaining an understanding of the organisation's strengths, weaknesses, opportunities and threats (see [Chapters 5 to 7](#) in this book). However, just as important as understanding the internal and external environment is the infrastructure that enables the organisation to obtain intelligence about its environment and turn it into useful insights that enable it to make decisions. This effort to improve the speed and quality of strategic decision-making is what we refer to as **strategic decision enablers**. Strategic decision enablers refer to the combination of people, processes and technology that enables the organisation to obtain intelligence about its environment and turn it into useful insights that enable it to make strategic decisions.

Strategic decision-making is a complex and ongoing process. The information required for it will reflect these complexities, as outlined below:

- Forward and backward-looking information enables proactive decisions that will direct the organisation in the future.
- The organisation needs an internal and external focus to align internal resources with external opportunities and threats.
- Strategic decisions cannot focus on every single detail – it thus needs to focus on the 'big issues'.

CASE EXAMPLE: Telkom's decision to sell its share in Vodacom¹⁹

Ineffective decision-making in conditions of uncertainty can be risky and costly, as Telkom found out when it sold its 50% share in Vodacom in 2009, and opted to enter the South African mobile industry with its own brand, Telkom Mobile. One of the key reasons for its sale of Vodacom shares was the restrictive shareholders' agreement, which Telkom felt was hampering its ability to compete more aggressively in the mobile telecommunications industry. The decision has subsequently been 'recognised as one of the company's biggest mistakes,' said chief strategy officer Miriam Altman. 'Would Telkom have succeeded in building Vodacom in the same way [as Vodafone has]? I don't know. But I think [selling Vodacom] was one of Telkom's biggest mistakes,' Altman said.

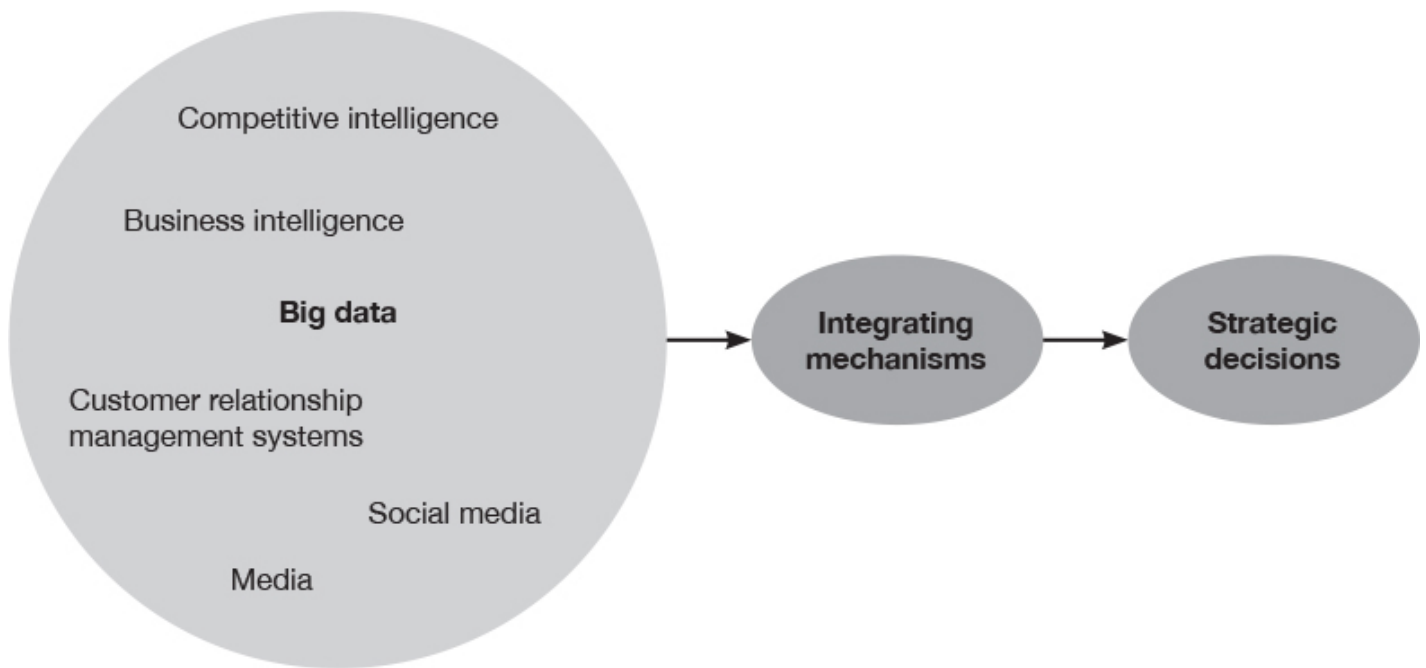
In the six months ending September 2013, Telkom Mobile lost R773m before interest, tax, depreciation and amortisation. That was a deterioration from a loss of R716m in the same period a year ago. Altman said it's 'very unlikely' that Telkom Mobile will succeed if it must rely on organic growth only.

- Information is obtained from many different sources. Good strategic information integrates the different types of information from different sources to develop a 'big picture' of the organisation's environment and its place in this environment.
- Information is not objective, and different managers may interpret the same information differently depending on their personal characteristics and goals. It could thus be said that the interpretation of information has both a cognitive and a political component.

Figure 4.2 depicts our view of strategic decision enablers. Typically, organisations engage in environment-scanning activities, commonly known as **competitive intelligence** (CI), that focus on the external environment. These activities generate mostly unstructured data about competitors and other external factors. Internal information systems, commonly known as business intelligence systems (BIS), provide structured information on the organisation's historical performance. By their nature, business intelligence systems provide structured, often quantitative, and historical information. In the more recent past, the notion of **big data** has come to the fore. Big data refers to the very large and complex data sets in large organisations that require advanced and unique data storage, management and analysis.²⁰ It refers to the large amount of data that engulfs organisations as a result of formal and non-formal data collection (including CI and BIS).

The information obtained from these sources is generally disparate and fundamentally different. The organisation therefore requires integrating mechanisms to analyse and integrate information and present it in a useful format to the strategic decision-making process. These mechanisms may be people, processes or technologies (individually or in combination) that add value to information. These mechanisms can also help to reduce the information overload that many managers must deal with every day, and help to improve the quality of the information. In the following sections we discuss each of the elements of strategic decision enablers, namely big data, competitive intelligence, business intelligence systems and integrating mechanisms (as shown in Figure 4.2) in more detail.

Figure 4.2 A framework for strategic decision enablers



4.4.1 Big data and strategic decision-making

The large amount of data generated by every organisation, both structured (e.g. from sales transactions) and unstructured (e.g. from environmental scanning activities), gave rise to the term 'big data'. The process of turning big data into useful information (**big data analytics** or business analytics) is one of the key challenges of contemporary organisations. Big data presents the organisation with four problems:²¹

1. The sheer *volume* of data is astounding, with IBM estimating that 2020 will see the creation of 43 trillion gigabytes of data (40 zettabytes) – 300 times more than in 2005. Most organisations are drowning in data that they struggle to make sense of, with the result that they are generally data rich but insight poor.
2. Big data presents organisations with a large *variety* of data, from highly structured transactional data to unstructured qualitative data in various formats, such as comments by customers on social media, emails or telephonic complaints.
3. The *velocity* of data is also increasing with data constantly streaming into the organisation, and the challenge is to analyse data that is constantly changing and updating.
4. The *veracity* (truthfulness) of the data is sometimes hard to verify, and IBM reports that one in three business leaders do not trust the data that they use for business decision-making.

From a strategic decision-making perspective, we can see that strategic decision enablers are required to assist strategic decision-makers in making sense of big data. In the next two sections, we focus on two specific sources of strategic information, namely CI and BIS.

4.4.2 Competitive intelligence (CI)

One of the key strategic processes of any organisation is to scan the external environment constantly. Some authors suggest that while competitive intelligence is the body of knowledge on how to collect and use intelligence, **environmental scanning** considers when an organisation should collect intelligence to support strategic decision-making.²² Environmental scanning refers to the efforts of executives to gather intelligence to sustain their competitive advantage.²³ However, some of the later research in this field proposes that constant, active

environmental scanning is critical.²⁴ This suggests that the traditional conceptual boundaries between CI and other environmental scanning activities have blurred. For our purposes, these environmental scanning processes are collectively known as competitive intelligence or CI. Admittedly, the term ‘competitive intelligence’ is somewhat misleading as CI has evolved to focus not only on competition but also on the broader business environment. Some of the aspects that CI should focus on are described below:

- *Competitors and complementors*: Who are they, what are they planning, what are their strengths and weaknesses, and how will they react to our strategies? (The competitive environment is discussed in more detail in [Chapter 6](#).)
- *Customers and distribution channels*: What are their needs, values and behaviours? Which customers are at risk of defecting to the competition?
- *Suppliers*: How reliable are they? What ambitions do they have, and how will this affect the organisation?
- *Economic environment*: What are the key changes in economic indicators, and how will they affect the organisation? (The macroenvironment is discussed in more detail in [Chapter 5](#).)
- *Technological environment*: What new technologies are emerging that could present an opportunity or threat?
- *Industry regulators and legislation*: What new legislation or regulation is pending, or how might future changes affect the organisation? Who is influencing legislation or regulation?

CI is sometimes unfairly viewed as industrial espionage. In this regard, it is important to point out that CI practitioners should operate within a framework of strong ethical guidelines such as those provided by strategic and competitive intelligence professionals (SCIPs). (See the Case example *SCIP code of ethics for CI professionals*.)

Scanning the external environment provides an organisation with the best chance of detecting early signals of key changes or events in the external environment, and when they are likely to occur. Scanning therefore serves as an early warning system that identifies and appraises future opportunities for and threats to the organisation. The organisation can then focus further CI efforts on these opportunities and threats to assess them and aid decision-making.

CI directly supports the strategic decision-making processes in the organisation. For example, if an organisation is considering investing in a foreign country, it can use CI to assess the macro- and industry environments in the country to appraise the viability of doing business in that market and industry.

Scanning the environment provides feedback on the strategic management process and thus enables corrective actions if required. For example, are the assumptions that we made when formulating our strategy still valid, and how might they change? Are competitors and customers reacting to our strategies as we expected them to? It therefore provides important input into the strategic risk management processes (see [Chapter 14](#)).

For practical purposes, we can define CI as the process of systematically scanning the business environment and identifying and assessing potential opportunities and threats. CI can support both strategic decisions, such as the decision to acquire a competitor, and tactical decisions, for example the pricing strategy for a new product. The focus here is on the strategic role of CI. In the next section we examine the CI process, widely known as the CI cycle.

4.4.2.1 The strategic CI cycle

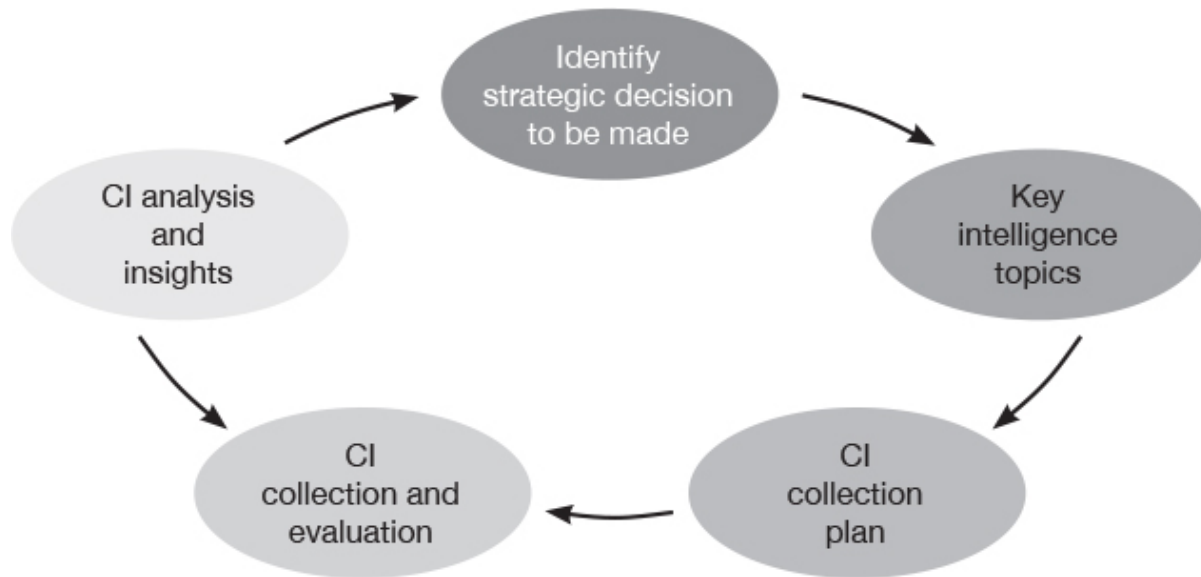
As illustrated in [Figure 4.3](#), the strategic CI cycle encompasses five steps, namely identifying the strategic decision to be made, identifying key intelligence topics, developing the CI collection plan, CI gathering and evaluation and CI analysis.

CASE EXAMPLE: SCIP code of ethics for CI professionals²⁵

- To continually strive to increase the recognition and respect of the profession.
- To comply with all applicable laws, domestic and international.
- To accurately disclose all relevant information, including one's identity and organisation, prior to all interviews.

- To avoid conflicts of interest in fulfilling one's duties.
- To provide honest and realistic recommendations and conclusions in the execution of one's duties.
- To promote this code of ethics within one's company, with third-party contractors and within the entire profession.
- To faithfully adhere to and abide by one's company policies, objectives and guidelines.

Figure 4.3 The strategic CI cycle



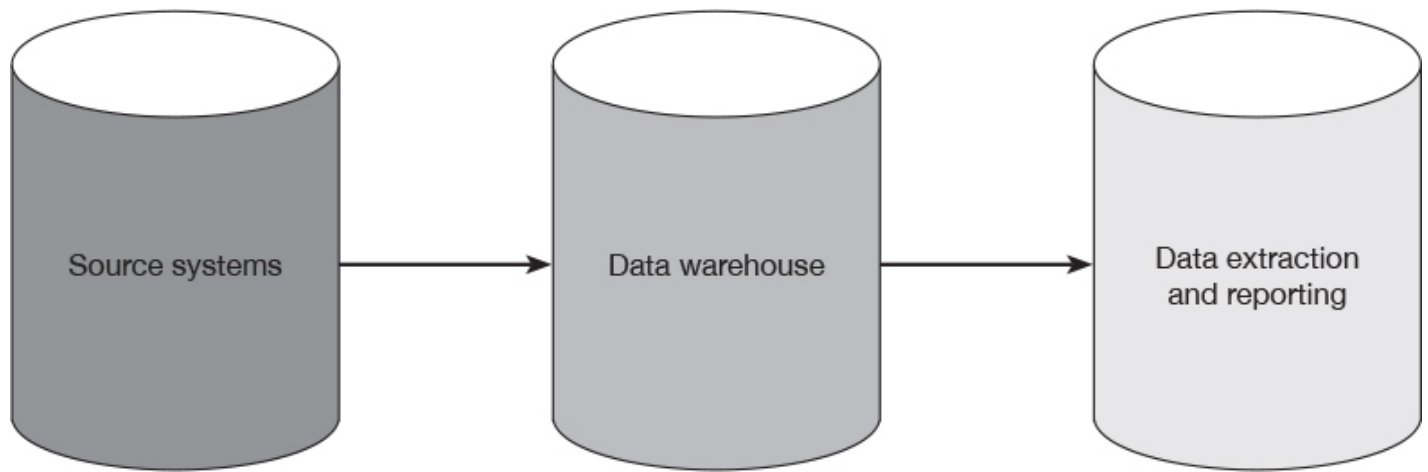
- *Step 1: Identify the strategic decision to be made*
The first step in the strategic CI cycle is to recognise the need for a strategic decision to be made.
- *Step 2: Key intelligence topics (KITs)*
In this process, the organisation must determine the focus areas for CI, as it is impossible to monitor the entire business environment. These focus areas are also known as key intelligence topics (KITs). It is important to note that the focus on KITs does not mean that normal scanning activities do not take place.
- *Step 3: CI collection plan*
The next step is to determine the CI collection plan. This determines the data sources that will be used, the people involved in the collection process, and how the data will be collected. There are many potential sources of CI. Intelligence can be collected from both primary and secondary sources.
It is generally easier and more commonplace to acquire information from secondary sources. These sources include market research organisations, online sources and existing company marketing research reports. In this regard, the internet has become a widely used tool for gathering secondary information.
However, CI and environmental scanning activities should never rely on secondary information only. Primary intelligence from human sources such as employees, customers and potential customers, distribution channel partners, competitors, complementors, suppliers and opinion leaders are all important primary sources of CI. The internet has also become a tool for primary intelligence gathering. For example, the rapid growth of weblogs (blogs) presents an intelligence opportunity as well as opportunities for engaging customers and other stakeholders in qualitative and quantitative enquiries online.
The most important sources of CI are outlined below:

- » *Primary information* may be obtained from competitors' employees, regulators, customers and other stakeholders in the form of structured or unstructured interviews. This is an area where the boundaries of ethics are often tested. For example, some organisations may conduct 'job interviews' with former employees of competitors purely as a means of gathering information.²⁶
 - » *Observation* of competitors' facilities and operations to establish the level of activity can be a useful external source of primary information.
 - » *Reverse engineering* of competitive products and *mystery shopping* (contacting a competitor for the purpose of observing how they operate) are also fairly commonly used methods of gathering information about competitors.
 - » *Publicly available information* in the press, on the internet and marketing information from competitors, for example product brochures, is a secondary external source of information. Blogs, online customer reviews and consumer complaints are also potential sources of useful information about competitors.
 - » *Institutional information* in the public domain, for example the patent office and Registrar of Companies, is another source of secondary external information.
 - » Internal sources include *intelligence* obtained from employees. This is critical as many experts have suggested that as much as 80% of what an organisation needs to know is in the heads of their employees. This also explains the link between CI and knowledge management.
 - » An aspect that is often overlooked is *competitive signalling*. While cartel forming is illegal, other methods, such as media releases or interviews, can be used to communicate intentions.
- *Step 4: CI collection and evaluation*
Data gathering then takes place as outlined by the data collection plan. At the same time, the source data is evaluated for credibility and value.
 - *Step 5: CI analysis and insights*
The next step in the process is to analyse the CI that has been gathered. The tools for analysis that are presented in [Chapters 5 to 7](#) are particularly useful in this phase of the process. Possible gaps and shortcomings in the data and findings are also determined during this phase. The last step in the process is to provide the findings to strategic decision-makers. Their insights and decisions will then influence the process again.

4.4.3 Business intelligence (BI)

Most organisations generate large amounts of data about their internal operations. Think of a retailer that is constantly generating data about sales transactions, customer data, purchasing transactions, debtor and creditor management, and inventory. In its raw form, this data is mostly useless to strategic decision-makers. The purpose of BI is to convert the massive amounts of raw data into useful and actionable intelligence. [Figure 4.4](#) presents a simplified view of BIS for purposes of the discussion that follows.

Figure 4.4 A simplified view of business intelligence systems



Data on its own has limited value and must be made available to strategic decision-makers in an integrated and usable format. This involves obtaining data from the various operational systems; extracting, transforming and loading (ETL) data into storage systems such as data warehouses or data marts; and then making it available to decision-makers in the format they require. Data cleansing, for example to resolve differences between data from disparate sources, is an important part of this process.²⁷

While the notion of BI has always included external sources of information (e.g. competitive information) and unstructured information, much of the focus during the early years was on integrating and extracting structured internal data. It could thus be argued that BI has not been entirely successful in integrating internal and external intelligence.²⁸

4.4.3.1 Source systems

One of the key challenges in BI is to obtain information from many different, often disparate, data sources. Large organisations may have many systems, but a few general examples of source systems are provided below:²⁹

- *Legacy systems* are historical and possibly outdated systems, but for some reason are still being used by the organisation. For example, it may be too costly to redesign the system.
- *Enterprise resource planning (ERP)* systems such as SAP are operational systems that have been developed over years to run a business and generate operational information. The focus of ERP is typically supply chain activities.³⁰
- *Customer relationship management (CRM)* systems are regarded as the marketing equivalent of ERP systems and serve to integrate the customer-facing functions such as marketing, sales and customer service.³¹
- *Online transaction processing (OLTP)* refers to those systems that facilitate and manage transaction-oriented applications, for example a bank's automated teller machines (ATMs).
- *Clickstream data* is the record of an internet user's 'virtual trail' that is left while surfing the internet. It includes details of activity on the internet, for example every website and every page of every website visited. This data is potentially valuable to internet marketers and advertisers.³²

The next step is to establish a facility to clean and store this data so that it can be accessed and analysed for decision-support purposes.

4.4.3.2 Data warehouse

The data warehouse has become widely accepted as the 'heart' of the BIS. It is typically a central system where information from diverse sources is combined to make it available to marketing and other decision-makers.

According to most authors, BI technology has coalesced around the use of data warehousing and online analytical processing (OLAP). The data from the various sources is brought together in a central storage facility, where it is archived and prepared for extraction by users of the information. In most organisations, this facility is known as a *data warehouse*. The purpose of a data warehouse is to provide rich, timely, clean and well-structured information to BI analysis tools.³³ Similarly, *data marts* are small-scale data warehouses designed to meet a specific function or department's BI needs.³⁴

4.4.3.3 Data extraction and reporting

The last step in the process of adding value to the organisation's data is data extraction for use by managers using management information and analysis tools such as OLAP, data mining and executive information systems, including dashboards. These are discussed briefly below.³⁵

- *OLAP* provides a means for users to view the data from a data warehouse in a multidimensional format, for example comparing data on geographic areas, product lines and time. It enables 'slicing and dicing', drilling down and rolling up as ways of examining data from many different angles.³⁶ This ability is potentially of great value to strategic decision-makers as it allows them to analyse complex data as a means of finding solutions to complex problems. For example, with OLAP, an organisation can determine that sales are declining in a particular region for a particular distribution channel and use this as a basis for action.
- The concept of *data mining* is becoming increasingly popular as a business information management tool where it is expected to reveal knowledge structures that can guide decisions in conditions of limited certainty. Data mining is an analytical process consisting of statistical techniques, artificial intelligence (AI) and database research. It is designed to explore data (usually large amounts, typically business or market related) in search of consistent patterns and/or systematic relationships between variables. It then validates the findings by applying the detected patterns to new subsets of data. Bradley defined data mining as 'an information extraction activity whose goal it is to discover hidden facts contained in databases, using a combination of machine learning, statistical analysis, modelling techniques and database technology, which infers rules that allow the prediction of future results'.³⁷ The ultimate goal of data mining is prediction. For example, retailers may use data mining to analyse shopping patterns and to predict what products are likely to be bought at the same time. This helps to optimise the shop layout and merchandising.
- *Executive information systems* (EIS) refer to operational data presented in the form of charts, tables and reports for the use of managers.³⁸ One particularly useful development in this regard has been the use of *management dashboards* as a means of presenting layered information in a simple, actionable format. All drivers know that they should keep their eye on certain key indicators in their car. Speed, the fuel level, engine temperature, the oil light and rearview mirrors are a few of the indicators that can be used to drive safely, and to monitor the performance and general well-being of the vehicle. If the oil light comes on, for example, the driver might stop at a service station and check the vehicle's oil level. In the same way, a dashboard allows the top management of the organisation to keep their eyes on the key metrics that indicate the performance of the organisation. Should one metric be in decline or out of line with the expected performance, the managers can follow up and determine what caused the deviation, and take corrective action to ensure that performance gets back on track. Dashboards allow managers to monitor the contribution of the various departments in their organisation using a few key indicators. Benefits of using digital dashboards include the following:
 - » The data on all critical business areas is presented in a simple visual format.
 - » Underlying data can be drilled into more deeply to generate detailed reports showing new trends or reasons for deviations.
 - » More informed decisions can be made based on real-time business intelligence.

- Finally, with the growing availability of global positioning data, geographic information systems (GIS) are of particular importance to strategic decision-makers. Many aspects of strategic decisions have spatial elements, for example the placement of distribution channels that a GIS addresses comprehensively. Its ability to present data in a map-based presentation addresses this spatial dimension and provides the data in a format that offers effective decision support. A further strength of GIS is its ability to integrate data from disparate sources.³⁹

Even the availability of BI in processed form is not always sufficient to support strategic decision-making. It is at this point that people, processes and technology, discussed in [section 4.5](#) below, can play a key role in adding more value to BI and CI for the benefit of strategic decision-makers.

STRATEGY IN ACTION: PPC's problems highlight challenges facing local companies venturing into Africa⁴⁰



In March 2017, PPC, southern Africa's largest cement maker, reported that its operating income from 2016 was down by 24%, while net profit attributable to shareholders declined by 88%. A five-year analysis of PPC's stock price shows the extent of the carnage, with the share price down almost 72% since 2012.

These troubling figures shine a spotlight on the analysis on which PPC's decision-making process relied when entering some of its African markets. According to Shiraaz Abdullah, an equity analyst at Sanlam Private Wealth:

'They commissioned their plant two months ago in the DRC, but the environment there is tough as it is linked to the political turmoil. Currently everyone is in limbo, the demand for cement is poor and when they commissioned the plant they expected huge returns ... Only Rwanda and Ethiopia have a pretty positive growth story. They are ramping up production and the markets are growing. In Zimbabwe, they are also not sure what is going to happen as elections approach.'

In South Africa, PPC is already facing difficult trading conditions, with low prices for cement, the threat posed by cheap cement imports from Pakistan and China, and slow economic growth compounded by credit ratings downgrades. In Africa, liquidity constraints, leadership uncertainty and a 9% fall in cement prices in Zimbabwe, the Democratic Republic of Congo and Botswana are some of the difficulties it faces.

PPC's ventures into Africa are a bittersweet tale of navigating difficult terrain and keeping an eye on the long-term gains to be reaped from its investments.

Adrian Cloete, a portfolio manager at PSG Wealth, said PPC's travails in Africa brought to the fore the extent of the difficulty of doing business in countries in the rest of Africa 'that have different cultures, markets and ways of doing business'.

But when the tough times do hit African operations, the massive investments made by South African companies in those markets make it difficult to pack up and leave. For example, PPC, across its four units in the DRC, Ethiopia, Rwanda and Zimbabwe, has invested in cement plants with a combined project cost of \$719m (about R9.2bn). The lifespan of its limestone reserves in Africa ranges from 12 years in Rwanda to 54 years in the DRC. Exiting these markets appears to be out of the question, so the challenge for PPC remains one of navigating current tough times while keeping an eye on the long-term prize.

Questions

1. What are the contextual aspects that played a role in PPC's decision to enter some of its African markets?
2. What strategic decision enablers could have assisted the organisation in its decision?

4.5 Integrating mechanisms

The value of **integrating mechanisms** lies in their integration of external, unstructured data (CI) with internal, historical, highly structured data (BI) and other big data elements to develop a richer picture of the organisation's

environment and provide insights that would otherwise not be possible. While people, processes and technology are all integrating mechanisms, it is really in the interaction between these elements that most value is added. There are many different manifestations of integrating mechanisms. We discuss a few examples of each below.⁴¹

4.5.1 People as integrating mechanisms

People provide the creative insights that cannot be duplicated by technology or process. The role of people in integrating intelligence is thus critical. In this section we discuss three manifestations of people as integrating mechanisms, namely intelligence teams, the executive intelligence officer and intelligence specialists.

4.5.1.1 Intelligence teams

The use of multidisciplinary teams is a notion that is generally accepted in management, yet they are rarely used as a means of adding value to CI and BI. In addition, research on the use of these teams in the context of competitive and marketing intelligence in general is scarce.

Multidisciplinary intelligence teams are a useful mechanism to add value to the strategy-making process. Research has shown that insight teams can make a positive contribution to strategic marketing decision-making by combining CI, CRM, data mining and marketing research.⁴² Research has also shown that learning teams (such as communities of practice where individuals with similar interests interact to improve their practice) have the potential to improve market intelligence and market integration skills.⁴³ Fahey and Herring provided some guidelines for the use of intelligence teams:⁴⁴

- The team consists of *core members* (typically competitive or market intelligence professionals) and *transient members* who are involved in the process only as and when needed.
- *Strategic decision-makers* should be closely involved in the activities of the team, directly or indirectly.
- The relative resource intensity means that the team will generally be used for complex *strategic intelligence issues*.
- The team should be *multidisciplinary* to avoid dominance by the ideas of one discipline and should include a range of analytical skills.
- It is always useful to include one or two members who can think 'outside the box' and *challenge conventional wisdom*. This leads to constructive tension that leads to more creative thinking.

The Case example *The use of an intelligence team* below describes the way in which one intelligence team was engaged to address a particular intelligence issue.

CASE EXAMPLE: The use of an intelligence team⁴⁵

- *Competitive context*: A large corporation competed against two equally large rivals in selling and delivering complex technological solutions to corporate, governmental and institutional customers.
- *Business issue*: Over a six-month period, customers seemed to deploy new purchasing criteria reflecting an underlying shift in their solution needs. The corporation failed to win two large accounts that it fully expected to land, and lost two of its longstanding and most visible accounts.
- *Strategic decision*: Senior managers realised that they now confronted a strategy decision without knowing what the alternatives were. How should they reconfigure their strategy to enhance and deliver superior customer value?
- *Intelligence challenge*: The core intelligence challenge consisted of a number of related items. How were customers' needs shifting? What might their likely trajectory be over time? What forces were driving the shifting customer needs? How might rivals' emerging strategies affect the dynamics of rivalry?
- *The intelligence team*: The team was led by a senior member of the organisation's business intelligence group. Its members included individuals from strategic planning, market research, marketing, sales and finance, plus

two executives who participated in the team's meetings whenever their schedules permitted.

- *The terms of reference:* The team was given eight to 10 weeks to complete its work. It was asked to depict how and why customer needs were changing, to explain why the organisation had lost key accounts, and to develop action recommendations that would contribute to a winning strategy.

4.5.1.2 Executive intelligence officer (EIO)

An executive intelligence officer or EIO provides a means of bridging the 'dysfunctional disconnect' between the strategic decision-making processes and the intelligence processes that exist in so many organisations. A possible reason for this disconnect is the lack of an intelligence-focused position at the top management level of the organisation.⁴⁶ The EIO assumes responsibility for the intelligence that the CEO and executive team require to do their jobs, and works as a collaborator with and partner to the top management team. The EIO's responsibilities should include the following:⁴⁷

- *Content leadership:* The EIO collaborates with the executive team to decide what issues to focus on and to prioritise the intelligence issues facing the organisation.
- *Intelligence quality assurance:* The EIO also evaluates intelligence sources for their dependability, consistency, predictability and overall quality.
- *Decision relevance:* The EIO should assist the organisation to focus on the highest priorities with regard to opportunities, risks and vulnerabilities.
- *Voice of realism:* The EIO uses facts and insights to provide a realistic perspective to counter the often emotional or even political arguments that can come to dominate top management thinking.
- *Education enabler:* Intelligence is knowledge, and thus often provides an opportunity for learning. The EIO can enhance the value of intelligence by using the dissemination of intelligence as an opportunity for mutual learning. For example, executive war games provide an excellent opportunity for sharing intelligence and also for gaining insights into how competitors might think.
- *Safe harbour:* The EIO should not judge any idea, opinion or question, but should rather encourage everyone to share their views and ask questions. This is the best way of stimulating debate and creativity.
- *Dot connector:* The EIO could ultimately be the individual with the best view of the big picture by integrating various data sources and events, and analysing them to provide unique strategic insights.

4.5.1.3 Intelligence specialists

The role of intelligence specialists is becoming increasingly important. Although these positions are known by a number of different job titles, for example CI officer, BI analyst, marketing intelligence officer or market researcher,⁴⁸ they have a certain intelligence role in common. They are increasingly expected to play a key role in the sense-making processes in the organisation by acting as intelligence 'bricoleurs' or builders, combining intelligence from different sources to provide insights and to support decision-making.

4.5.2 Processes as integrating mechanisms

Although there are many different processes that contribute to the integration and dissemination of intelligence, here we focus on three of the more important ones, namely knowledge management, the process of amplifying weak signals and scenario planning.

4.5.2.1 Knowledge management

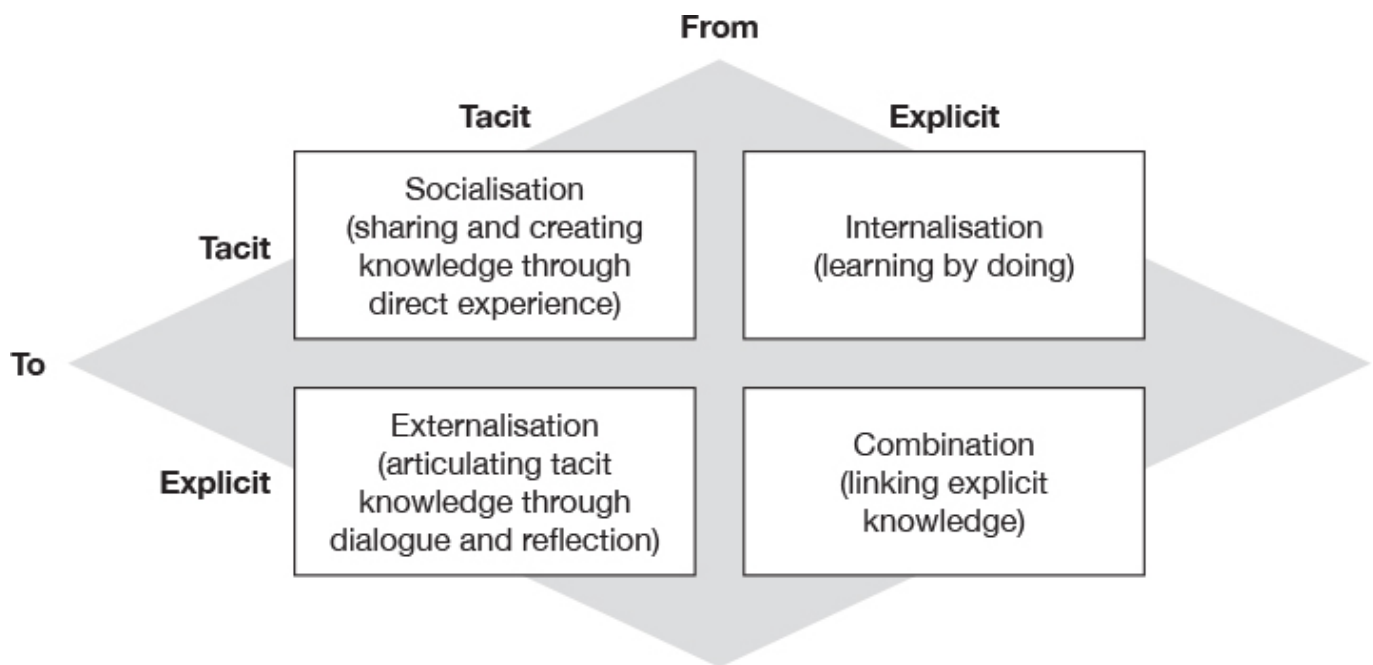
The concept of knowledge management or KM gained prominence with the notion of knowledge as a basis for competitive advantage,⁴⁹ and the emergence of the idea of a ‘learning organisation’ that constantly increases its knowledge and therefore its competitiveness. KM is described as the ‘systematic process of finding, selecting, organising, distilling and presenting information that improves an employee’s comprehension in a specific area of interest’.⁵⁰ From this definition, the links between CI, BI and KM become clear.

Another definition points out the sources of knowledge: ‘Knowledge management promotes an integrated approach to identifying, capturing, retrieving, sharing, and evaluating enterprise information assets. These information assets may include databases, documents, policies, procedures, as well as the uncaptured tacit expertise and experience stored in individual heads.’⁵¹

CI and BI activities constantly generate new knowledge, both explicit and tacit, and the internalisation of this knowledge by the organisation will ultimately be to its advantage. However, while it is often asserted that 80% of what organisations should know exists inside them, in the minds of employees there is also a commonly acknowledged challenge to bring this knowledge to the fore. This is essentially a KM problem.

Knowledge is generally divided into tacit and explicit knowledge (see also [Chapter 7, section 7.3.2.4](#) for a discussion on the relationship between knowledge and organisational capabilities). Explicit knowledge can be easily codified and transferred to others. Tacit knowledge cannot be easily transferred or copied, yet it is critical to the success of an organisation. One of the key challenges of KM is thus to find ways of sharing and internalising tacit knowledge. The role of KM is summarised in [Figure 4.5](#).

Figure 4.5 Processes for knowledge creation and sharing in an organisation⁵²



The highest level of knowledge sharing occurs when tacit knowledge is transferred from one individual or group to other individuals or groups. This takes place through a process of socialisation, and takes the form of observation of practice inside and outside the organisation, the accumulation of tacit knowledge through doing, and the deliberate transferring of tacit knowledge.

The next process is to transfer tacit knowledge to explicit knowledge to make it more widely known and easier to transfer. The process for doing this is externalisation, and takes the form of articulating and translating tacit knowledge in forms of communication that are readily understood.

Once knowledge is explicit, it can easily be linked and used in combination with other explicit knowledge. Gathering, integrating, transferring, diffusing and editing explicit knowledge facilitates the process of transferring explicit knowledge to explicit knowledge – in other words, adding explicit knowledge to other explicit knowledge in order to increase the explicit knowledge base.

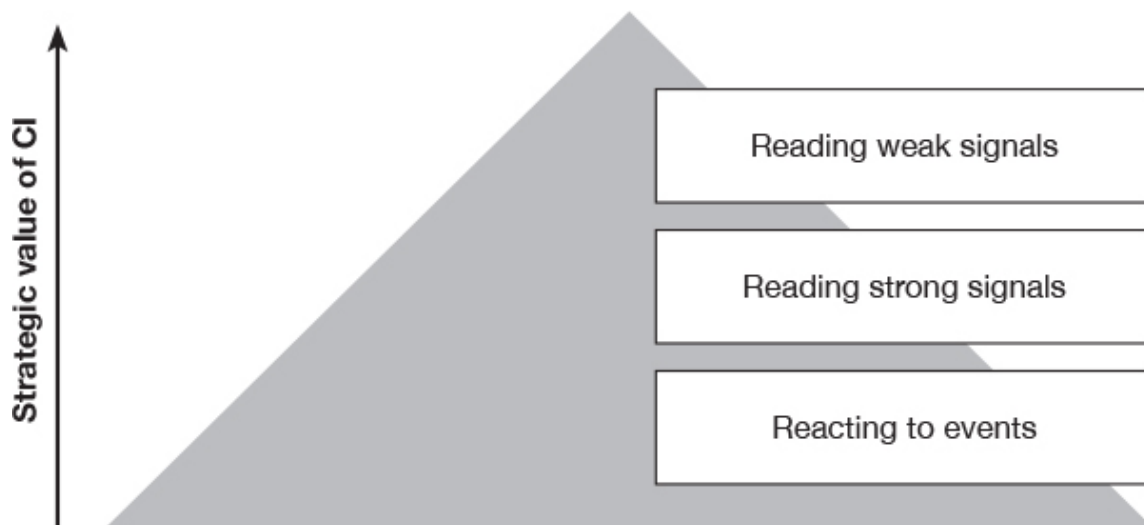
Ultimately the goal is to ensure that explicit knowledge becomes tacit knowledge – in other words, internalisation of explicit knowledge takes place. The mechanism for doing this could be simulation and experiments (such as flight simulators for pilots) and, more commonly, action and practice. The Case example The transfer of knowledge illustrates how these processes take place in practice.

4.5.2.2 Amplifying weak signals

With the deluge of information available to decision-makers, it is somewhat surprising that many industry experts feel that organisations are data rich but poor in useful information and insights. It could thus be argued that those organisations that are able to cut through the clutter to get to the intelligence that no or few other organisations have will be in a better position to establish a competitive advantage. This principle is depicted in [Figure 4.6](#), which suggests that organisations that are able to derive insights from weak signals are in a better position than organisations that simply react to events, or base their decisions on ‘strong signals’ that are visible and available to everyone.

[Figure 4.7](#) illustrates Schoemaker and Day’s process for amplifying weak signals⁵³ that builds on the idea of scenario analysis and planning (see also [Chapter 5, section 5.5.4.5](#)). The first step in the process is to have environmental scanning processes that actively search for weak signals by driving the search for intelligence down to local levels, by organising search parties, for example teams to investigate specific issues, and leveraging extended intelligence networks such as suppliers and customers. Weak signals can take many forms, for example rumours or casual remarks by a rival executive, but what differentiates them from other signals is that they are interesting, they are not in the public domain, nor are they on anybody else’s radar.

Figure 4.6 The strategic value of CI

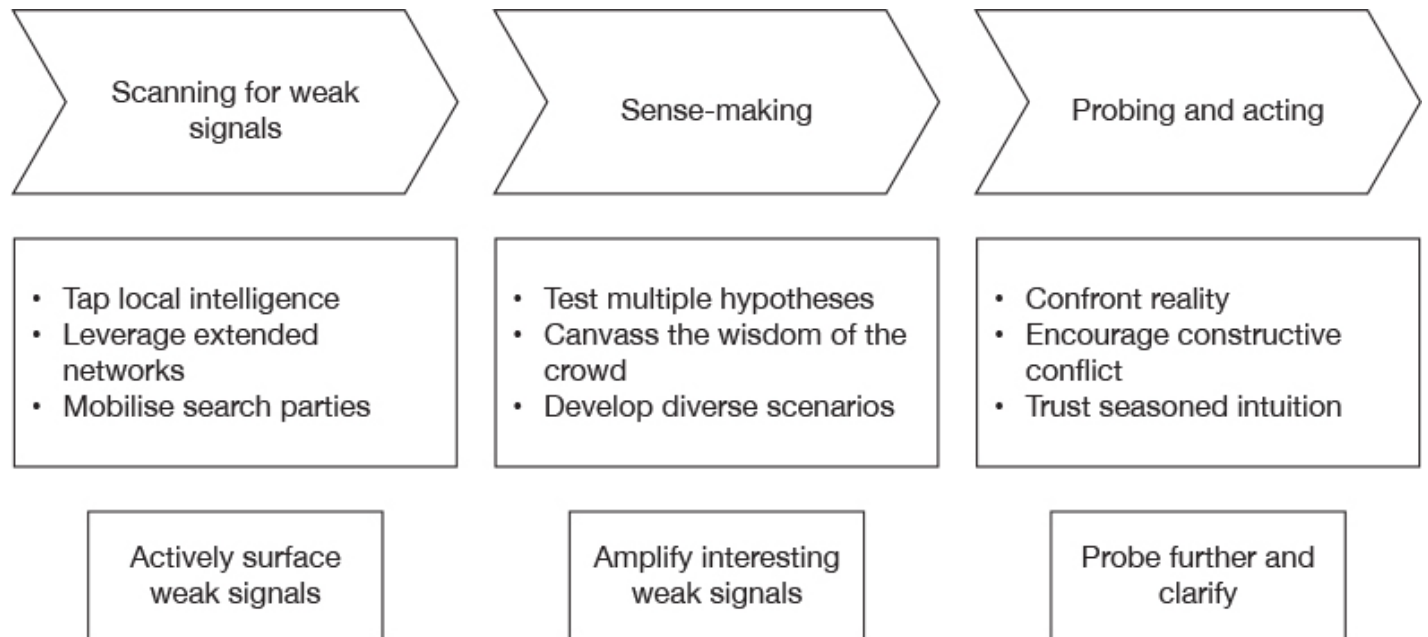


CASE EXAMPLE: The transfer of knowledge

A new employee in a section may initially start the knowledge transfer process by assimilating whatever is available in the form of explicit knowledge, such as training manuals, videos, policies and procedures, and organisation charts. Through doing and ‘practising’, he or she will become skilled, and will internalise the explicit knowledge so that it becomes tacit knowledge. The explicit knowledge is used less and less as a reference point.

As a skilled practitioner, the employee then exchanges ideas and experiences with colleagues and others, even outside the organisation, and through this process of dialogue and observation will enhance tacit knowledge and transfer it to others. At some point, the employee may transfer the tacit knowledge to explicit knowledge, for example by writing down a new process or methodology he or she discovered that improves productivity. This is later combined with other explicit knowledge, for example by taking up the new process in an updated training manual.

Figure 4.7 The process for amplifying weak signals



The next step in the process is to amplify the weak signal by experimenting with different competing hypotheses and scenarios, and at the same time canvassing a broader audience to obtain their insights. It is also important to gather more corroborating intelligence.

The last phase is geared to support decision-making, and involves the process of further clarifying the idea. This means encouraging constructive conflict and debate, gaining insights and intuition from seasoned managers, and confronting the reality of what is happening in the business environment, which may differ from the organisation's own paradigms and mental models.

4.5.2.3 Scenario planning

The purpose of scenario planning as a strategic thinking tool is to develop different perspectives of the future with the purpose of planning for contingencies. The power of scenarios as a learning tool for managers has also been emphasised, especially by Shell, who can be seen as a pioneer of scenario planning. There are four key applications:⁵⁴

- To help strategic decision-makers make sense of a complex situation
- To assist in developing robust strategies that will offer the best performance across a range of scenarios
- Anticipating changes in situations where the future is uncertain
- As an adaptive organisational learning tool for managers.

The complexity and potential cost and time implications of scenario planning means that it is not a technique suited to every strategic decision. In addition, the purpose of the scenario planning exercise should be clear before the

process is started, and the specific tools and techniques are selected.

There are various processes for **scenario analysis and planning**, all of which share some key elements, as discussed below:

- The organisation and the decision-makers involved in the scenario planning process should agree on the purpose of the scenario, the time horizon and the objective of the exercise.
- Scenario planning requires a common understanding of participants of the organisation and the key uncertainties and driving forces in its business environment.
- The scenario planning team will have to agree on a few key drivers or key uncertainties.
- The key uncertainties are used to create possible and plausible scenarios in the form of a narrative or a matrix. There should not be too many scenarios – typically, three or four scenarios are generated.
- Depending on the desired outcome, the scenarios should be widely communicated. Having catchy names for scenarios and using visual aids such as graphs or cartoons can help to have the best possible impact for the communication process.
- The next step in the process is to generate strategies. The best possible outcome is when there are strategies that are robust across all different scenarios.
- Finally, as part of the strategic risk management process the organisation needs to look for signals that might indicate if one scenario is becoming more likely than the others.

While the classic outcome of a scenario planning exercise is a narrative (typically three ‘stories’ about the future), there are also other possible outcomes that have become more popular over time. In summary, there are three typical ones:

- A narrative, typically stories about the future, such as the Dinokeng scenarios for South Africa.⁵⁵ The purpose of the Dinokeng scenarios were to present the possible futures of South Africa and its citizens by 2020, and it presented three stories about the future, namely Walk Apart, Walk Behind and Walk Together.
- The use of a two-by-two matrix (or ‘gameboard’) outlining four contingencies has become very popular in the last few years.⁵⁶
- With the increasing use of computers, simulated environments have become more popular and more powerful as ways of exploring scenarios. In conjunction with strategy war games, they can become powerful ways of gamifying strategic planning and learning about strategies.⁵⁷

Scenario planning is unique seeing as it often combines people, processes and technology in one event, as well as simultaneously providing a platform for learning and decision-making. In the Case example, we can see how scenario planning can be used even at a country level. (Also refer to scenario planning in [Chapter 5](#).)

4.5.3 Technology as an integrating mechanism

While there are many different types of technology that influence and support strategic decision-making, in this section we focus on two broad categories of software, namely planning and decision-support tools, and artificial intelligence (AI).

- *Planning and decision-support tools* refer to a variety of tools in several categories that may be used to support the planning and decision-making processes in an organisation. This includes simulation tools and planning templates.⁵⁸ *Strategy simulations*, for example, can assist strategic decision-makers in asking ‘what if?’ questions and testing the outcome. This is useful in strategic planning processes such as scenario planning and war gaming. *Planning software* is often simply a productivity tool, but it does allow the integration of various types of data and insights in one cohesive document.

- AI is a category of technology that simulates human thinking patterns. There are three main categories of AI applications:⁵⁹
 - » Expert systems are computer systems with a well-organised body of knowledge that emulates expert human decision-making within an established set of rules. This generally works better with lower-level applications where the number of assumptions and decision rules is manageable.
 - » Artificial neural networks (ANN) simulate the working of the human brain by using a large number of interconnected 'neurons' to allow a computer system to 'learn' by example. One drawback of ANN is that it can only use data that is numerically presented, and it is thus limited in its ability to integrate structured and unstructured data.
 - » Intelligent agents are computer systems in some specified environment that are able to take autonomous action to meet design objectives. In the process, agents act autonomously, interact with other entities and agents, can reason about themselves, and can be mobile. Possible applications in strategic decision enabling include the gathering of intelligence about specified topics and the filtering of intelligence to decision-makers.

While we have now considered the different aspects of strategic decision enablers, it is also useful to consider how the strategic decision-making process takes place (especially in volatile environments) and how strategic decision enablers can support it.

CASE EXAMPLE: Scenarios for South Africa⁶⁰

On 21 June 2018, President Cyril Ramaphosa addressed the launch of Indlulamithi South African Scenarios towards 2030 at the Kyalami Theatre on the Track in Midrand, Gauteng.

The South African Scenarios is an independent project initiated by respected academic Dr Somadoda Fikeni, multinational Anglo American and the Mapungubwe Institute for Strategic Reflection (MISTRA), and is aimed at framing a national conversation, beyond the current national trajectory, to answer the question: 'What would a socially cohesive South Africa look like, and to what degree is it attainable by 2030?'

The Indlulamithi South African Scenarios 2030 considers, among other things, the economy, work and society, environmental justice, reconciliation and redress, and crime and safety.

President Ramaphosa has welcomed the initiative, and last week at the briefing facilitated by the team of the Indlulamithi South African Scenarios towards 2030 said: 'Any nation that seeks progress and development must be able to first envision it. The Indlulamithi Scenarios help the country understand the possible paths it can take and what needs to be done now to ensure that it takes the path of greatest cohesion, prosperity and equality.'

The Indlulamithi project continues a long tradition of scenarios for South Africa, starting with the Anglo American 'High Road'/'Low Road' scenarios of the mid-1980s, and continuing through the Nedcor/Old Mutual project of 1991–92, the Mont Fleur scenarios of 1991–92, and most recently the Dinokeng scenarios of 2009.

4.6 Improving the quality and speed of strategic decision-making

Strategic decision-making is focused on the long term, and determining the quality of a strategic decision by its outcome is almost impossible – there are simply too many other factors that could have had an impact on the final result. However, there are certain guidelines that strategic decision-makers can use to speed up decision-making and improve the quality and efficiency of the strategic decision-making process, namely to build multiple alternatives, to track real-time information, to seek the views of trusted advisors and to build consensus, but not at any cost. The guidelines are discussed in more detail below.⁶¹

4.6.1 Building multiple alternatives

Rather than investing all the available time and effort into developing just one alternative (and risking the alternative being rejected and having to start over), multiple alternatives should be developed and presented. This has the additional advantage of reducing management bias that may result in certain alternatives being eliminated early on in the decision-making process because of political reasons, for example.⁶²

4.6.2 Tracking real time information

Instead of relying on trends and statistical analyses (which may age very quickly anyway), managers in fast-moving environments may be more predisposed towards real-time information, which focuses on the latest information from current operations. This is typically obtained by spending face-to-face time with key staff members and by 'wandering around'. Using a medical analogy, the key is having a finger on the pulse all of the time, rather than periodical check-ups.

4.6.3 Seeking the views of trusted advisors

The experience of older, more experienced managers can be very valuable, often more so than more extensive analyses by more junior staff members or consultants. Decision-makers in fast-moving environments will often have a network of such experienced managers as 'trusted advisors'.

4.6.4 Aiming for consensus, but not at any cost

It is important to understand that searching for consensus may be a fruitless goal. It is far more important to stimulate conflict and debate, and allocate a realistic time frame (e.g. 3–4 months) to making strategic decisions. If the allocated time has lapsed and consensus has not been reached, a decision is made using a decision rule (e.g. by voting, or the manager with the highest stake in the decision makes the call).⁶³ In this way, decision pace and rhythm can be maintained. So, while consensus should be the 'first prize', a strategic decision-maker should have the courage to force a decision at a certain point despite the status of consensus-seeking efforts.

4.6.5 Building collective intuition

Developing a common understanding of the business and its environment among decision-makers is an important way of reducing unnecessary conflict and disagreements, and improving decision agility. In order to do this, managers need to share real-time information on the organisation's internal operations and external environment at regular compulsory meetings.

4.6.6 Stimulating quick conflict

Conflict, while often seen as a bad thing, is necessary to obtain different viewpoints and robust alternatives. One way to achieve conflict is to assemble decision-making teams that are diverse in their background, functional areas and corporate experience. Using tactics such as scenario planning or war-gaming to challenge the status quo or the obvious solutions is another way of achieving quick (yet productive) conflict). Working with multiple alternatives also stimulates conflict and debate.

4.6.7 Defusing politics

The potentially negative effect of politicking on strategic decision-making can be reduced by emphasising common goals, by ensuring that all managers have a clear area of responsibility where they have the final say, and by using humour to make the strategic decision-making process fun.

4.7 Summary

Strategic decision-making is a complex activity that differs from organisation to organisation. Because the quality of strategic decisions is hard to link to the strategic decision-making process, it is difficult to ascribe the success of a strategic decision to any particular approach or 'recipe'. Every organisation needs to find its own most appropriate manner of making strategic decisions. In this chapter we examined the various approaches to strategic decision-making, and the many contextual influences on it, which further highlighted the complexity of this important activity. It is easy to forget that the analysis of information on the macroenvironment, industry and internal environment is ultimately the result of a process of intelligence gathering, analysis and dissemination. Many organisations tend to focus on and use information that is close at hand, and easy and cheap to obtain, for example internal financial information, or online information in the public domain. However, as this chapter points out, the quality of intelligence is related to the investment in obtaining intelligence from internal and external sources in line with strategic direction. It is also related to the use of integrating mechanisms in the form of people, processes and technology to add value to the intelligence for the sake of the decision-makers. This is not necessarily a cheap and easy option, but research and experience have shown that organisations willing to do this have the opportunity to develop a competitive advantage. Contrary to intuition, the role of information becomes even more important in volatile environments, and we have seen that managers play a key role in interpreting and distributing information in the organisation. We have also highlighted that managers can use simple approaches such as stimulating conflict and developing collective intuition to improve decision quality, speed and efficiency in organisations.

REFLECTION BOX:

In a 20-year study of 80 000 predictions by experts from various fields, it was found that they were only slightly more accurate than pure chance, and fared worse than even the most basic computer algorithms.⁶⁴ What are the implications of this finding for strategic decision-makers?

Opening case questions

1. Use the strategic decision framework in [Figure 4.1](#) to explain what went wrong with Telkom's Multi-Links decision.
2. Provide a breakdown of the types of strategic market intelligence that Telkom would have found useful in the Multi-Links decision.
3. Identify and explain the sources of intelligence they could have used.
4. Identify and explain the mechanisms they could have used to integrate and interpret intelligence.

Discussion questions

1. Describe what strategic decision-making is and what it is not.
2. Explain how strategic decisions are made.
3. Explain how context influences strategic decision-making.
4. Is big data useful to strategic decision-making? Why, or why not?

5. In the case of a potential new competitor entering the industry, give examples of:
 - a) five key intelligence topics
 - b) the CI activities that will assist strategic decision-making
 - c) the BI that will assist strategic decision-making
 - d) the integrating mechanisms that will be useful in integrating and analysing intelligence
 - e) if and how scenario analysis can be used.
6. Explain how an organisation could go about improving the quality and speed of its strategic decision-making process.

Using knowledge and skills

1. Select an organisation of your choice. Interview three managers in this organisation to identify their strategic decision-making processes and their use of integrating mechanisms (people, process and technologies).
 - a) How does this organisation make strategic decisions?
 - b) Given its context, do you feel that it uses an optimal strategic decision-making process?
 - c) What could the organisation do to improve the quality and speed of the strategic decision-making process?
2. Visit the web page of the Dinokeng scenarios. Would you say that they are useful in guiding strategic decision-making for organisations? Motivate your answer.

Further reading

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Suggested websites

- Advanced Competitive Strategies (<http://whatifyourstrategy.com/>) – The website of advanced competitive strategies that contains many publications on and examples of the use of competitive simulation.
- AWARE (<http://www.marketing-intelligence.co.uk>) – A website with examples of strategic and tactical competitor intelligence.
- IBM Big Data & Analytics Hub (<http://www.ibmbigdatahub.com/infographic/four-vs-big-data>)
- Indlulamithi: South Africa Scenarios 2030 (<https://sascenarios2030.co.za>)
- SCIP (<http://www.scip.org/>) – The official website of Strategic and Competitive Intelligence Professionals.
- The Knowledge Management Society of Southern Africa library (<http://kmsa.org.za/library>) – Provides a number of useful resources about knowledge management

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- 56. You can see an example of such a gameboard at <http://www.mindofafox.com/>
- 57. ValueWar© is an example of a computer tool that enables the creation of simulated environments as a means to explore future scenarios. You can visit <http://whatifyourstrategy.com/> to read more about this approach.
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CHAPTER 5

Analysing the macroenvironme

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Ernst Neuland

LEARNING OUTCOMES

After reading this chapter, you should be able to:

- define and describe the external environment that organisations face
- discuss the importance of analysing and understanding an organisation's external environment
- explain the strategic importance of macroenvironmental analysis in strategy formulation
- define and discuss the macroenvironmental factors and forces of importance to organisations
- describe how analysing an organisation's macroenvironmental turbulence can be approached
- explain the nine basic steps in environmental analysis
- evaluate the merits of the SWOT and PESTEL approaches, the Issues Priority Matrix and Scenario Analysis in analysing an organisation's macroenvironment.

KEY TERMS

collectivist

economic risk

foreign direct investment

globalisation

gross domestic product

gross national income

individualistic

issues priority matrix

scenario analysis and planning

strategic myopia

OPENING CASE STUDY



MTN's quest for growth in Africa¹

Headquartered in South Africa, MTN's footprint spanned 22 countries in Africa and the Middle East in early 2017. It was estimated that revenues for 2017 would come mainly from the following regions: South Africa 31%, Nigeria 28%, Iran 12%, Ghana 8%, and the Ivory Coast 6%. The remainder of the countries were expected to each contribute 4% or less to total revenues. Despite its continued success since its listing on the JSE in 1995, MTN has shed 48% of its share price in the past few years. MTN's new CEO Rob Shuter and his finance director Ralph Mupita have ambitious plans to revive the company after a number of setbacks, such as a huge fine in Nigeria, and Shuter has already implemented the 'BRIGHT' strategy based on the following six pillars: best customer experience; returns and efficiency; igniting commercial performance; growth via data and digital; hearts and minds; and technological excellence.

Referring to prospects in Africa, Shuter states that cellphones in Africa are mostly used for basic communication (like voice and SMS messages), but with voice revenues falling globally, data and digital as well as enterprise business are destined to become star performers. 'Currently we have a population of around 650 million people in the countries in which we are involved, and expect that market to grow to some 700 million people by 2020. Basically, it is like adding an entire South Africa to the current market,' Shuter says.

The next 100 to 200 million people entering our market are expected to come from rural areas. MTN will have to provide the right technology to them – not only regarding the networks, but also the appliances that will have to be made available to them. 'This market is comprised mainly of young people and they accept new technology much more readily than their parents. MTN accordingly expects a huge upsurge in the demand for mobile internet in Africa,' Shuter states.

Despite the fact that MTN currently operates in six of the 10 most corrupt nations according to Transparency International data (the countries being South Sudan, Syria, Yemen, Sudan, Afghanistan and Guinea-Bissau), MTN also had to face huge challenges in recent years, such as the devastating US\$1.5 billion fine in October 2015 against MTN's subsidiary in Nigeria that failed to disconnect the unregistered SIM cards of some 5.2 million subscribers in order to comply with new regulations that had come into effect. However, the original penalty of US\$1.5 billion, which led to the resignation of the former CEO, was eventually settled at US\$1 billion. 'We are, however, still here, and I believe the company has a positive future despite these challenges,' Shuter maintains. MTN expects an improvement of the Nigerian economy mainly due to higher oil prices, while the 'winds of change' currently sweeping South Africa have also raised expectations regarding prospects ahead.

At Deloitte's Conference on Africa's Prospects for 2018 held at Woodmead, Johannesburg, in January 2018, Shuter informed the audience: 'We are optimistic about growth prospects in Africa and the Middle East. However, our focus remains on our key geographical areas which include South Africa, Nigeria and Iran.' It appears that demands on MTN's cash are finally easing up, which gives Rob Shuter's new team an opportunity to revive MTN's African expansion drive, which had come to a halt in recent years. Shuter specifically flags Angola and Ethiopia as two countries MTN is keen on entering. Angola has a population of around 31.2 million, is characterised by low economic growth and has a mobile phone subscription rate of 55.3 per 100 people. Ethiopia, with a population of around 102.4 million, exhibits a much higher economic growth rate of 7.4 percent, and has a mobile phone penetration of 69.9 per 100 people. However, Nick Hedley of the *Financialmail* poses the question as to whether MTN's risky foreign forays will come back to bite it again.

Overview

This chapter focuses on the external business environment and, more specifically, on the macroenvironment in which the organisation operates. The need for and importance of **macroenvironmental analysis**, at times also referred to as environmental scanning, a systematic process of collecting and analysing information for the purposes of planning, and forecasting or choosing a preferred future will be demonstrated through discussion, evaluation and interpretation of identified macroenvironmental factors and forces for strategic management purposes. The approach to and methods of macroenvironmental analysis as a prerequisite for strategy formulation conclude this chapter.

5.1 Introduction

In the preceding chapters we explored the nature of strategic management and the requirements for sustainability in a dynamic, complex and increasingly competitive external business environment. We now turn to strategic analysis, the phase of the strategic management process that involves the evaluation of both the external and internal environments of the organisation. While the external environment is comprised of two main components – the macroenvironment and the industry environment – in this chapter we focus on the macroenvironment and its analysis.

The Opening case study relates to MTN, a listed South African telecommunications company with operations in 22 countries throughout Africa and the Middle East. Different countries have vastly different political and **legal systems**, are at different stages of economic development and also differ in terms of economic growth. Apart from the need to be intimately informed regarding these factors, MTN also needs to be acutely aware of demographic and sociocultural issues, especially when contemplating international expansion. In fact, being aware of and understanding the implications of these environmental differences is imperative to effectively adapt an organisation's strategies, products, services and operations to such vastly different environments, thus the need for environmental analysis or scanning of the relevant macroenvironments of interest to organisations. In this chapter we accordingly focus on the structure of the macroenvironment and the importance of macroenvironmental analysis in general, while the global implications of strategic analysis are highlighted in [Chapter 11](#). Industry analysis and its role in the strategic management process are explored in [Chapter 6](#), and internal analysis of an organisation's resources, capabilities and competencies is addressed in [Chapter 7](#).

5.2 Strategic relevance and structure of the external environment

The strategic management process has evolved as an innovative way of aligning an organisation's unique resources, capabilities and competencies to the dynamic and increasingly competitive external environment in pursuance of its goals, including through strategic stretch or strategic fit, as highlighted in [Chapter 1](#). As illustrated in the Opening case study, striving to achieve such alignment has certainly been one of the main challenges inherent in MTN's international expansion initiatives. As we will see, external environmental forces can manifest themselves as opportunities or threats to an organisation's competitiveness, sustainable growth and profitability, just as internal forces or factors could represent inherent competitive strengths or weaknesses within an organisation. For example, recall the devastating US\$1 billion fine MTN was expected to pay because of its failure to disconnect the unregistered SIM cards of 5.2 million subscribers in response to regulatory changes by the Nigerian authorities. This could be seen as a political/governmental macroenvironmental threat. To respond effectively to external challenges such as these, organisations need to know and understand their external as well as their internal environments and pre-emptively obtain the relevant information they need for effective strategy formulation.² Important interrelationships between the organisation and its external environments are illustrated in [Figure 5.1](#).

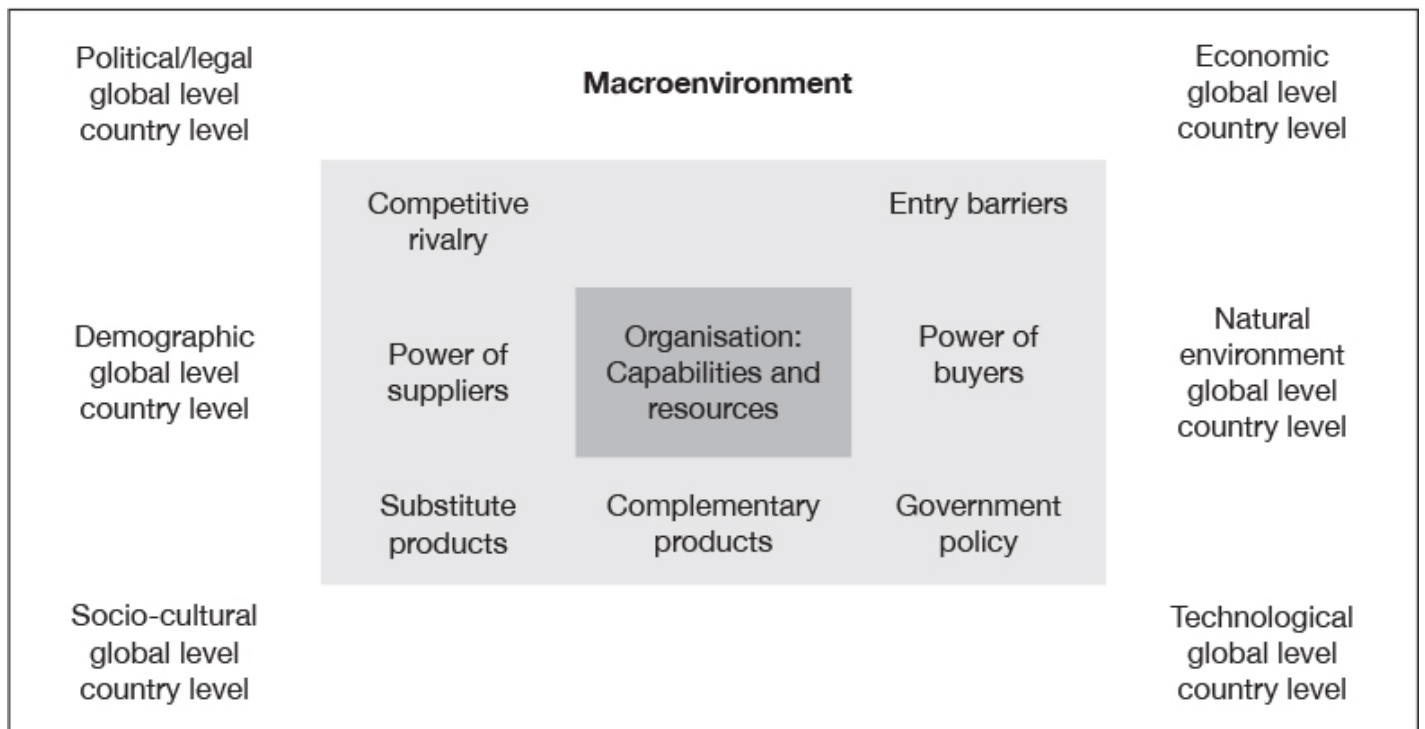
To facilitate further discussion in the chapter, the respective external environments and internal environment of the organisation are now defined with reference to [Figure 5.1](#).

- The **external environment**, comprising the macroenvironment and industry environment, includes everything outside an organisation at global, country and industry levels that might affect the ability of the organisation to attain its goals. The external environment includes factors beyond the control of the individual organisation such as major global, regional and national politically and economically related events and new technological breakthroughs, as well as industry factors that influence its choice of strategic direction and actions.³
- The **macroenvironment**, as a component of the external environment, includes political, legal, economic, sociocultural, technological, demographic and natural environmental forces at global level and/or within a

country. These forces, whether global or related to a specific country, originate beyond and are usually irrespective of any single organisation's operating situation.⁴

- The industry environment, also a component of the external environment, includes actual and potential competitors, suppliers, buyers (customers or distributors) and organisations that supply substitutes to those products sold in the industry, and organisations that provide products which are complements to those sold in the industry. Governments generally also influence industry environments.⁵ (The industry environment is discussed in [Chapter 6](#)).
- The internal environment constitutes everything inside the organisation, and in particular its resources, capabilities and competencies that might enhance or constrain the ability of managers to pursue certain actions or strategies, and over which management typically has control.⁶

Figure 5.1: Structure of the external environment



The **global business environment** as part of the broader macroenvironment indicated in [Figure 5.1](#) is pervasive and provides a contextual frame of reference for the economies of individual countries and, more specifically, for industries and organisations within those countries. Global environmental forces that could impact countries, industries within countries, and organisations within those industries are also classified into political-legal, economic, sociocultural, demographic, technological and natural environmental categories for purposes of strategic analysis. The above relationships are evident from [Figure 5.1](#) and explored further in [Chapter 11](#) where we discuss the nature and implications of globalisation and the global business environment for **international businesses** and their strategies. However, the above-mentioned forces arising from the global environment will not affect all countries, or all industries and their organisations within countries, in the same way, to the same extent and at the same time, once again emphasising the need for pre-emptive environmental scanning and analysis.

In the section that follows we now discuss the strategic importance of the macro-environment.

5.3 Strategic importance of the macroenvironment

The macroenvironmental factors tend to exert forces that have a major influence on industries and hence on organisations operating within them. As previously stated, these macroenvironmental forces will not affect all industries, and organisations in those industries, in the same way. Forces emanating from macroenvironmental factors indicated in the outer band of [Figure 5.1](#) (political/legal, economic, sociocultural, technological, demographic and natural factors at the global and individual country levels) therefore need to be identified, analysed and interpreted in terms of their potential impact on an organisation's strategic direction, competitiveness, profitability and, ultimately, on its survival. Since change is inevitable, and given the organisation's existing vision and mission, the information obtained from effective scanning of the macroenvironment and forecasting the implications of macroenvironmental factors in the future will assist management to understand the organisation's preferred future better, as well as where it wants to be at a future point in time.

Palmer and Hartley⁷ contend that '[i]nformation represents a bridge between the organisation and its environment and is the means by which a picture of the changing environment is built up within an organisation. Management therefore needs to transform information and competitive intelligence obtained from macroenvironmental analysis into knowledge that can be used for strategy formulation.' Management has the responsibility to conduct this macroenvironmental analysis in order to use this information to create strategy formulation. As far back as 1991, Nonaka realised the importance of knowledge when he proclaimed that '[i]n economies where the only certainty is uncertainty, the one sure source of lasting competitive advantage is knowledge.'⁸

It should thus be evident that a clear link exists between the information obtained from comprehensive environmental analysis of the organisation's external (macro- and industry) and internal environments, and its ultimate choice of strategy that effectively aligns the organisation's internal and external environments.

The importance of assessing the organisation's macroenvironment (and its internal environment) is furthermore confirmed by the two approaches to strategy formulation discussed in [Chapter 1](#), the inside-out and the outside-in approach, both of which recognise and acknowledge the existence and importance of aligning an organisation's external and internal environments better than competitors do, in effect achieving superior strategic fit and sustainable competitive advantage.

Examples of how macroenvironmental forces have influenced specific industries and their member organisations, which obviously required rethinking of existing strategies, include the following:⁹

- Notwithstanding the challenges of rising international oil and petroleum prices and increasing environmental pressures to combat pollution, recent breakthrough technological advances have resulted in the large-scale manufacture of electric-powered vehicles and self-driving cars, leading to dramatic new competitive dynamics in the vehicle manufacturing and transportation industries worldwide.
- The ageing of the population in many countries, and especially in developed countries, has already resulted in the reconfiguration of important consumer market segments to cope with changing consumer needs and buying behaviour. Ageing populations hold implications for the healthcare industry and financial retirement fund sectors, as well as opportunities for the leisure and tourism industries resulting from increased affluence of the elderly in certain communities.
- Almost the opposite trend still exists in many emerging economies where, *inter alia*, due to relatively low comparative life expectancy and relatively high fertility and birth rates, the youth segment is becoming increasingly important compared to the higher age groups, presenting a potentially lucrative youth market for more affordable products, which many multinational enterprises (MNEs) from developed countries, to their detriment, failed to appreciate due to inadequate and poor macroenvironmental analysis.

These examples clearly illustrate the complex nature of certain macroenvironmental forces in terms of their global nature and potential impact on multiple industries or sectors within and across countries. These important

relationships, where new developments in an industry frequently impact various other industries at the same time, are discussed in [section 5.4.9](#).

Change in the external environment in general, and the macroenvironment in particular, may occur gradually or rapidly, with or without warning.¹⁰ Gradual change, especially in stable environments such as in the retail sector, would typically allow organisations to timeously align and adapt their competitive strategies to new, gradually emerging situations – generally, despite intense competition. However, change could also be rapid, discontinuous, unanticipated, radical and disruptive, often posing extreme challenges for organisations within such industries to effectively adapt their strategies to the new or rapidly changing circumstances before competitors do, or disappear from the scene. The strategic implications of environmental turbulence are highlighted in [section 5.5.2](#). Under conditions of environmental turbulence, the decision of adapting a blue ocean strategy comes to the fore, as we further explain in [Chapter 11](#). Examples of new, disruptive technological change that were mostly not foreseen are highlighted in the following Case example.

CASE EXAMPLE: Are you really coping with radical environmental change?¹¹

As far as radical change is concerned, Grant (2015) maintains that the perils of radical change are not difficult to understand. At the core is the difficulty that established companies experience in developing the new organisational capabilities demanded by new circumstances or a new area of business. Udo Gollub concurs when stating that in 1998, Kodak had 170 000 employees, and sold 85% of all photographic paper worldwide. Within just a few years, their photographic paper film business model disappeared with the advent of digital photography. What happened to Kodak will happen to a lot of industries in the next 10 years – and most people do not see it coming. Did anyone think in 1998 that three years later they would never take pictures on film paper again? (Kodak survived extremely difficult times by eventually adopting digitisation). However, rapid unanticipated change in macroenvironmental forces could lead to significant market expansion (as in the case of [Amazon.com](#) rapidly capitalising on new technology, changing buyer behaviour and optimising logistics) or market contraction (the replacement of video cassettes by extremely efficient compact disc technology within a short space of time, while there are already signs that the same fate awaits compact discs due to digital streaming and related techniques), and even to new levels of industry competition (as in the case of Uber providing extremely efficient innovative, cost-effective, globally competitive civilian transport initiatives as an alternative to metered taxis at the time of writing). Even more dramatic is the development of ‘air taxis’ or ‘flying taxis’ by Uber, Google and Geely that will provide intra- and inter-city air transportation to commuters instead of conventional road transport. The aforementioned examples undoubtedly serve to confirm the importance of pre-emptively scanning and analysing the macroenvironment for trends that could impact specific industries and companies, and although such changes are important by themselves, their implications are often not foreseen or totally ignored.

In the section that follows we take a closer look at the more important macroenvironmental factors and forces from a strategy perspective.

5.4 Factors and forces of the macroenvironment

5.4.1 Introduction

The previous sections briefly described and illustrated the structure of the environments that business organisations generally face, and highlighted the importance of the macroenvironment in terms of its potential influence on industries and their organisations. While the analysis of macroenvironmental factors and forces are referred to in [section 5.5.4](#), we first highlight the nature and characteristics of the following broad categories of factors and forces in the macroenvironment:

- Political-legal
- Economic
- Socio-cultural
- Demographic
- Technological
- Environmental.

Organisations need information and strategic intelligence about these macroenvironmental factors and their driving forces for the purposes of strategy formulation. We accordingly provide a brief overview of these factors, illustrate the potential impact of their forces on industries and organisations, and conclude by highlighting the possible interrelationships of these forces between and across industries.

5.4.2 Political-legal factors

It is generally accepted that there is a strong relationship between the political, legal and economic systems of a country – this relationship is often referred to as the political economy of a country. Political processes and legislation define the legal and regulatory parameters that influence industries and organisations within those industries.¹² Political stability and effective legal systems in a country are therefore of major importance for business ventures with regard to successfully executing their strategies as planned.

Political-legal factors may either benefit or constrain the organisations they influence. As an example of the beneficial political influence on business, refer to the Case example below, indicating the envisaged scrapping of the rules on local mine ownership limitations instituted by the previous Zimbabwean government that required 51% ownership by citizens of Zimbabwe, but is no longer a requirement in this regard. On the other hand, an example of a constraining influence is found where India's government policy does not allow the establishment of foreign wholly-owned subsidiaries in the Indian retail sector, but joint ventures with Indian counterparts are acceptable.

The potential effects of these forces are major issues that require serious consideration in the evaluation of the macroenvironment. Pearce and Robinson¹³ state that political constraints placed on organisations could include trade policies, competition policy, tax programmes, labour legislation, anti-pollution and pricing policies, the regulation of e-commerce, and safety and security measures, all of which are generally aimed at the protection of the workforce, consumers, the public and the environment. These constraints, despite their 'protective' aims, typically tend to increase costs and reduce the profits of organisations. Some political-legal actions, however, do serve to protect and benefit the business sector. Laws that protect patents and other forms of intellectual property, the provision of grants and subsidies for training and development of the workforce, and funding to encourage research and development in strategically important areas generally tend to enhance business development. The following case example on Zimbabwe illustrates a beneficial political-legal outcome for international mining companies in Zimbabwe.

CASE EXAMPLE: Zimbabwe may scrap rules on local mine ownership¹⁴

During the Mugabe era the Zimbabwean government required that companies mining minerals in the country, including platinum and diamonds, must be at least 51 percent owned by black citizens of the country. However, while mining is Zimbabwe's biggest source of foreign exchange and the country also has the world's second largest platinum reserves, this ruling on ownership law has become a serious concern for foreign investors. During January 2018, President Emmerson Mnangagwa, who became president of Zimbabwe after Robert Mugabe resigned, announced that the ownership requirement on all other minerals except platinum and diamonds will be abolished. He stated that the government needed to assess these industries more carefully as they are vital an economy that has halved in size since 2000 after a land reform program slashed the export of

major agricultural products. The world's two biggest platinum producers, South Africa's Anglo-American Platinum and Impala Platinum Holdings, who operate mines in Zimbabwe have slowed investment plans because of concern over ownership law and that they also had to concede their concessions to the government. President Mnangagwa went on to say that platinum and diamonds were only excluded for now. The sector experienced a bleak first quarter. Nothing had happened and Zimbabwe's Chamber of Mines, which presents most of the mining companies in the country, wanted ownership restrictions on platinum and diamond mining operations to be officially scrapped to attract more important industry players like Russian giant Alrosa PJSC. This case clearly demonstrates how the political environment can enhance or deter international business initiatives.

Government legislation has facilitated deregulation and the privatisation of state-owned enterprises (SOEs) in many countries – a particularly strong trend in the US in recent decades – in most cases with significant benefits for the SOEs, the industries and countries concerned. For example, deregulation of the commercial airline industry in the US between 1978 and 1993 led to 29 new airlines entering the industry during this period, resulting in vastly increased passenger-carrying capacity, new route networks that had to be served, more intense competition, and price wars – all of this posing entirely new strategic and competitive challenges to the airlines concerned. This is an excellent illustration of how macroenvironmental issues influence organisations through their impact on the industry in which they operate.¹⁵ In South Africa, notable successful privatisation initiatives to date include Telkom and the Airports Company of South Africa (ACSA). Based on the generally accepted benefits of privatisation, there still seems to be a reluctance by the South African government to consider total or even partial privatisation of SOEs, which include South African Airways, Eskom and Prasa (Passenger Rail Association of South Africa).

Industry-specific regulators present a further example of an important but often overlooked political-legal factor in the macroenvironment that has a direct impact on an industry. Industry-specific regulators are government agencies or statutory bodies with the responsibility of formulating, interpreting and implementing rules and regulations governing various elements of a specific industry, shaping the structure and intensity of competition in that industry, thus presenting opportunities or threats that organisations within that industry may face. A typical example in South Africa is the Independent Communications Authority of South Africa (ICASA), a government-controlled entity that regulates the telecommunications industry. For example, they grant licences to provide telecommunication services as has been the case with mobile telecommunication operators MTN, Vodacom and Cell C. Telkom and Neotel (which is in the process of being taken over by Liquid Telecom) were still the only fixed-line operators in the industry at the time of writing in early 2018. These organisations have to operate and compete within the regulatory framework of ICASA in South Africa.

However, MTN and Vodacom in particular have expanded their operations to other African countries and further afield, where they face and have to comply with, *inter alia*, different political, legal and sociocultural systems in each of the foreign countries in which they are involved – aptly illustrated by MTN's venture into Iran in 2006, basically an Islamic country with a theocratic political system and a judiciary based on Islamic law. Despite the numerous challenges MTN has had to face since entering Iran in 2006, its financial expectations have been vindicated.¹⁶ The role of industry-specific regulators in driving industry competition is discussed in more detail in [Chapter 6](#).

In closing, analysis of the political-legal factors in the macroenvironment should include an assessment of the potential for **political risk**. Political risk is the likelihood that political forces will cause drastic changes in an organisation's business environment that will adversely affect its profit and other objectives. These risks are extremely difficult to forecast and usually occur unexpectedly. Notable political-legal risks that management should be aware of are the following:

- Government nationalisation of industries
- Expropriation of property as well as private sector assets
- Inadequate protection of intellectual property rights

- Absence of the rule of law
- Unfair competition from the public sector
- Government intervention in business operations and activities
- Unexpected imposition of discriminatory taxation and barriers to international trade and industry investment, often with profound adverse economic implications for the business sector in the country concerned
- Unexpected imposition or tightening of foreign exchange controls
- National hostilities and military intervention, more often in a regional or international context.

The purpose of examining political-legal factors is not only to create an awareness of their importance as regards the extent of political stability in a country and a government's ability to create and nurture an enhancing business environment, but also to pre-emptively act on relevant, strategically important political-legal information.

5.4.3 Economic factors

The national economy of a country has an impact on industries, business and non-profit sectors, consumers and society in general.

Hill and McShane identify the following four important factors in the economic environment of a country:¹⁷

1. *The growth rate of the economy* Economic growth generally leads to increased consumer spending, business expansion, profits and employment. In contrast, economic decline reduces consumer spending, increases competition, and has an adverse effect on profits and employment, which was evident during the global financial crisis from 2006 to 2009 and affected all countries to a greater or lesser extent – including South Africa.
2. *The level of interest rates* The level of interest rates can influence the demand for an organisation's products or services. Interest rate levels are particularly important when customers need to borrow money to finance purchases, as increasing interest rates tend to inhibit purchases of luxury items and products such as appliances and cars. This is most evident in the residential property market where transactions are extremely sensitive to high interest rates. For organisations in this sector, high interest rates undoubtedly pose a serious threat.
3. *Currency exchange rates* Exchange rates reflect the differences between national currencies. Exchange rate movements have a direct impact on the demand for an exporting organisation's products in foreign markets. In the period leading up to the end of 2001, the value of the rand fell dramatically against that of the US dollar, and while some negative factors emerged, the cheaper rand boosted the export sales of South African companies, who were more price competitive purely because of the currency exchange rate. An adverse effect at this time was the increasing costs of imported goods and services due to a weaker rand against the US dollar, and the potential adverse effects thereof on inflation and interest rates.
4. *Price inflation* Inflation tends to have a destabilising effect on a national economy in terms of slower economic growth, higher interest rates, and depreciating currency characterised by undesirable volatility in exchange rates. High and continuous inflation, furthermore, makes it difficult to predict the future, which leads to greater uncertainty, especially as far as fixed investment decisions are concerned. For this reason, foreign investors are reluctant to commit their funds to long-term investments under conditions of uncertainty. The combined effect of the above-mentioned issues related to inflation will slow down an economy as well as consumer spending, adversely affecting profits.

Economic performance of a country is reflected by its **gross domestic product** (GDP), **gross national income** (GNI), and GDP or GNI per capita. GDP is a measure of the value of goods and services produced in an economy during a specific period, whereas GNI measures the total income received by the residents of a country. Economic growth results from productive activities by organisations in a country which, in turn, result in an increase in these

measures for a country over time. Apart from the four economic factors discussed above, other factors or indicators are useful in assessing a country's macroeconomic environment. These include the following:

- Income levels within a country
- Levels of disposable income
- Levels of saving
- Unemployment rates
- National debt
- Stock market indices, such as movements in the All-Share Index on the JSE over time
- Confidence in a country as a destination for **foreign direct investment** (FDI), indicated by the global FDI Confidence Index. FDI constitutes the direct investment in business opportunities in a foreign country.

As will be discussed in [section 5.5.4.5](#), static data at a certain point in time with regard to all the factors discussed above has limited value for purposes of an organisation's strategic decision-making and strategy formulation for the future. Trend analysis of these macroenvironmental factors over time provides more useful information, although this method has limitations when compared to scenario analysis as discussed in [section 5.5.4.4](#).

What is important, however, is that the timing and relative success of particular strategies can be influenced by changing economic conditions where adverse changes generally reflect economic risk, mainly due to the mismanagement of a country's economy. Government's monetary policy has a bearing on interest rates and inflation levels through regulation of monetary supply. Government also influences the economic climate in a country, mainly through taxation as well as expenditure on societal needs such as healthcare, education, welfare and infrastructure.

Employment levels or, more importantly, unemployment levels have become a matter of grave socio-economic concern in many countries worldwide, including South Africa. While the official unemployment rate in South Africa was 27.5% at the time of writing in late 2018, the youth unemployment rate hovered around 40% attributed, *inter alia*, to low economic growth since South Africa's GDP remained well below 1%, over the two years to the end of 2017.¹⁸ Looking beyond the traditional and obvious remedy for unemployment by, *inter alia*, attracting fixed investment to stimulate economic growth (a major challenge in itself), are there other (possibly unrelated) macroenvironmental forces that need to be considered, given the continuous, rapidly changing global business environment? If we keep in mind that strategising requires strategic thinking from a futures perspective, the Case example *Whence employment and careers?* provides a few thought-provoking, futuristic scenarios regarding employment.

CASE EXAMPLE: Whence employment and careers?¹⁹

- IBM Watson, referred to as IBM Watson Analytics, is a smart data analysis and visualisation service in the cloud that helps anyone to identify patterns and meanings in data. Watson is named after IBM's first CEO, Thomas Watson.
- In the US, young lawyers are already struggling to find employment due to the computer analytics system IBM Watson, which can provide legal advice on basic issues with 90% accuracy within seconds. As the software develops further, the system will be able to answer more complex questions, and in future one might require legal specialists only for very specific and complicated cases.
- IBM Watson also allegedly assists qualified nurses to diagnose cancer more accurately than doctors traditionally do.
- Facebook currently has pattern recognition software that can recognise faces better than humans can, which could render certain security-related jobs redundant.
- Employment in certain sectors of insurance-related companies could be profoundly affected when self-drive cars become mainstream after 2020, with accidents expected to drop from the current one accident every 100

000 kilometres to one every 10 million kilometres. The current car insurance business model is bound to disappear.

The emergence of global economic forces due to **regional economic integration**, resulting in the formation of trade blocs and free trade areas, have generally become increasingly important for international business. Current trade blocs and free trade areas such as the European Union (EU), the North American Free Trade Agreement (NAFTA) (the name of which is due to change in the near future), the Association of South East Asian Nations (ASEAN) and the Southern African Development Community (SADC) have had and still have a profound effect on business involvement in the global economic landscape, where regional economic integration involves agreements among countries in a geographic region to reduce, and ultimately remove, tariff and non-tariff barriers to the free flow of goods, services and factors of production between each other. For example, economic and trade policies enforced by these groups could present both opportunities and threats, and affect organisations, especially those involved in business with member countries of these groups, in terms of the ease or otherwise of entering their markets, in turn requiring organisations to adapt their strategies to new and continually changing situations.²⁰ These and other global issues, including their continuing convergence in international markets and the strategic implications of them, are again referred to in **Chapter 11**.

5.4.4 Sociocultural factors

Sociocultural factors and forces in an organisation's macroenvironment refer to the way in which changing social values and norms, beliefs, attitudes, traditions, lifestyles and other culture-related attributes of a nation, society or a group – its culture – affect an industry, and hence the organisations within that industry, where these changes could create opportunities or threats.²¹ Sociocultural changes could occur as a result of religious, ethnic, educational, demographic, lifestyle and ecological changes.

As social attributes of a nation, society or group change, so does the demand for different types of products and services. Like other forces in the macroenvironment, sociocultural forces are continually changing, some more rapidly than others, as a result of the evolving needs of individuals. Sociocultural forces often change in response to shifting environmental factors, including globalisation, that influence buyer behaviour through gradually altering values and beliefs. The strategies of organisations need to be adapted to changing sociocultural factors by creating new products for both existing as well as new emerging markets, and adapting existing products to avoid obsolescence. Management therefore needs to pre-empt the effects that changing sociocultural factors could have on market size, industry competitiveness and profitability. Generally, the only way to be pre-emptive is to scan the macroenvironment, identify and analyse those forces relevant to the organisation and its industry, and act on the information obtained.

Notable social trends in recent times include the following:²²

- Single parents, single-parent households or child-headed households, which have become increasingly prevalent in South Africa, exhibit different buying and consumption patterns compared to other types of family units.
- The increasing percentage of women in the workplace, as well as in leadership and management positions in both the public and private sectors, in developed as well as in developing countries like South Africa, lead to higher levels of disposable income, relatively more sophisticated lifestyles and a demand for new and different types of products and services.
- New trends in education, skills and talent development, combined with an increasing number of dual income families, have resulted in higher basic and disposable incomes, changing lifestyles, and a demand for new, innovative products and services.

- Increasing trends toward health and wellness present new opportunities and challenges for organisations to provide exercise and fitness centres and facilities, exercise equipment and clothing, health foods and beverages, nutritional supplements and organic food products. In an interesting move, the Italian sweet manufacturer, Ferrero Rocher, acquired the sweets manufacturing division of Nestlé in the US, allowing Nestlé to focus more on the growing market for health foods, beverages, bottled water and pet food.²³
- New opportunities for leisure and recreation results in a growing demand for SUVs and outdoor equipment, given the advantages of South Africa's extremely favourable climate.
- A major change in the age distribution of the population is an important trend that we will explore further in our discussion on demographics as a macroenvironmental factor in strategy development.
- The impact of HIV/Aids, from a macroenvironmental perspective, holds serious economic, socio-economic and demographic implications, especially for the economically active population of a country – but also has far-reaching implications for a country's healthcare sector and its family life. This is evident from the following Case example.

CASE EXAMPLE: HIV/Aids – an unforgiving phenomenon²⁴

The situation regarding HIV and AIDS and selected indicators at the end of 2016 are outlined below:

- The total number of people living with HIV globally was 36.7 million, of which 1.8 million were children.
- Of the 36.7 million people living with HIV, around 30% of the adults were not aware of their status.
- In 2016, HIV/Aids accounted for the deaths of one million people worldwide.
- The vast majority of people living with HIV are located in low- and middle-income countries, with an estimated 25.5 million living in sub-Saharan Africa, who in 2016 accounted for 44% of all new infections globally.
- Most encouraging, however, was that new infections have been declining by 16% per year from 2010 to 2016, with 1.8 million infections in 2016, down from 2.1 million in 2015.
- The number of people living with HIV in major regions of the world in 2016 was as follows:

» East and Southern Africa	19.4 million
» West and Central Africa	6.1 million
» Asia and Pacific	5.1 million
» Western Europe, Central Europe and North America	2.1 million
» Latin America and the Caribbean	2.1 million
» Eastern Europe and Central Asia	1.6 million
» Middle East and North Africa	0.23 million
- Of extreme importance to business in general is the devastating effect of HIV/Aids on the economically active segment of the population – notwithstanding a gradual decline in the number of people living with HIV/Aids, mainly due to the availability of antiretroviral medication in recent years.

As previously stated, management should be aware that certain macroenvironmental factors or forces can present both opportunities and threats. For example, the increasing trend toward health and wellness, which has been identified as an opportunity for this sector, has become a threat to the tobacco industry because of a greater awareness of the health risk associated with smoking.²⁵

While most of the sociocultural changes referred to above have generally been fairly gradual, management should be exceptionally alert to rapid and especially radical, disruptive sociocultural changes, such as those referred to in [section 5.4.6](#) below.

5.4.5 Demographic factors

Demographic shifts are at the root of many changes in a society, and include changing trends with regard to population size, growth and composition, rising or declining affluence in certain segments of a population, and changes in the ethnic composition of a population over time, also as a result of the migration of people where immigrants would probably contribute to greater ethnic diversity. More information on the regional population data for the world in 2017 can be seen in [Table 5.1](#).

Owing to globalisation, greater freedom of movement than before and increasing refugee streams from often devastated, developing countries to mainly developed countries, have accelerated in recent years.

Changes in regional or national geography and increasing urbanisation present new dynamics, also with the potential of new opportunities and threats. Cultural diversity, differing lifestyles and levels of affluence present significant strategic marketing opportunities to meet new consumer expectations and needs. Demographic criteria or variables could further include age, life expectancy, gender, race, religion, sexual orientation, social class, level of education, family size and orientation, and group rather than individual orientation, the latter typically found in **collectivist** and **individualistic** societies respectively. Collectivist societies typically emphasise collective goals and group harmony as opposed to individual goals. Individualistic societies typically emphasise the importance of guaranteeing individual freedom and self-expression in pursuance of individual goals.

Changes in any one or more of these criteria or variables over time could have a significant impact on certain industries and organisations within those industries, *inter alia* where one or more of these criteria or variables could change the buying behaviour of consumers, specifically for various age groups. In this regard, projections indicate that between 2000 and 2050 the expected growth rates for the various age groups worldwide are as follows: 0–14 years: 0.15%; 15–59 years: 0.79%; 60+ years: 2.35%; and 80+ years: 3.4%.²⁶ It is obvious that the impacts of these changes will vary across industries, giving rise to differing opportunities and threats that have to be timeously identified.

As previously stated in [section 5.3](#) and in terms of the projections highlighted above, it should be clear that the ageing population has rather significant implications for healthcare as well as home healthcare, retirement communities and recreation, which may once again present opportunities or threats. For example, ageing combined with affluence with regard to a certain segment of the population could present opportunities and threats to organisations in upmarket retirement complexes (lifestyle), the financial sector (investments and pensions), and travel and tourism (lifestyle, leisure and transportation).

Table 5.1 Growth in internet users (millions), 2000–2017²⁷

World internet usage and population statistics, June 30 2017						
World regions	Population, (2017 est.)	Population (% of world population)	Internet users 30 June 2017	Penetration rates (% population)	Growth (2000–2017)	Internet users (%)
Africa	1 246 505 865	16.6%	388 376 491	31.2%	8,503.1%	10.0%
Asia	4 148 178 672	55.2%	1 938 075 631	46.7%	1,595.5%	49.7%
Europe	822 710 362	10.9%	659 634 487	80.2%	527.6%	17.0%
Middle East	250 328 574	3.3%	146.972 123	58.7 %	4,374.3%	3.8%

World internet usage and population statistics, June 30 2017						
World regions	Population, (2017 est.)	Population (% of world population)	Internet users 30 June 2017	Penetration rates (% population)	Growth (2000–2017)	Internet users (%)
North America	363 224 006	4.8%	320 059 368	88.1%	196.1%	8.2%
Latin America/Caribbean	647 605 645	8.6%	404 269 163	62.4%	2,137.4%	10.4%
Oceania/Australia	40 479 846	0.5%	28 180 356	69.6 %	269.8%	0.7%
WORLD TOTAL	7 519 028 970	100%	3 885 568 619	51.7%	976.4%	100.0 %

5.4.6 Technological factors

We have witnessed astounding technological change in the global economy over the past two decades to the extent that it has become unthinkable that organisations not operating at the frontier of new technological developments will remain competitive, survive and grow. As outlined in [Chapter 9](#), technological change has become pervasive and can be both creative and disruptive. As previously referred to, sudden technological breakthroughs have far-reaching consequences for specific industries and the organisations within them. New technological products may present unique opportunities for an organisation, or entirely new products may render existing products obsolete. Technological innovation can create entirely new industries (e.g. the cellphone industry), alter the boundaries of industries (e.g. each new generation of cellphones has included additional features, such as cameras, internet connectivity and geographic positioning systems (GPS)), or lead to the demise of existing industries (e.g. MP3 players, which rendered CD players obsolete, and are in turn threatened by digital streaming of music and related new technologies). Examples of this continuous and often radical technological change is aptly illustrated in the Strategy in action case below

STRATEGY IN ACTION: Technology – is there an end in sight?²⁸



Udo Gollub (2016) summarises a number of key points regarding possible future implications of technological developments that he gathered during a recent Futurist Conference of the Singularity University Summit held on 3 December 2016 at Messe, Berlin, in Germany. What follows is a summary of how participants envisaged the world will operate in 10 to 20 years' time, given the unabated technological advancement that we are already experiencing.

- Arrival of the 'Exponential Age' means that software and operating platforms will disrupt most traditional industries in the next five to 10 years, as already evidenced in the case of Uber, regarded as just a software tool that does not own any cars but is now the biggest taxi company in the world, and in the case of Airbnb, the biggest 'hotel company' in the world, although they do not own any properties.
- In artificial intelligence (AI), computers have become exponentially better at understanding the world. Recently a computer beat the best Go (the abstract strategy board game) player in the world, 10 years earlier than expected.
- Certain occupations may be rendered obsolete in future due to technological advancements, as in the case of IBM Watson now being able to provide instantaneous (basic) legal advice, and enabling nurses to diagnose

cancer relatively effectively (as previously referred to in [section 5.4.3](#)).

- Electric cars are expected to become mainstream around 2020, with substantially lower levels of air and noise pollution.
- While the first self-driving cars were expected to become available in 2018, the entire car industry will be disrupted by 2020. Some implications: it will not be necessary to own a car anymore – people will call a car to take them to their destination, be able to work while commuting, and will not need parking; it is expected to change cities, fewer cars will be needed, and parking spaces and garages could be converted for productive use; and accident rates will drop dramatically, radically affecting the vehicle insurance industry.
- Most traditional car manufacturing companies may become bankrupt by not taking the evolutionary approach, and by just continuing to build better conventional cars, while technology companies like Tesla, Google, Uber and Apple will take the revolutionary road and build a ‘computer on wheels.’ It is believed that some car manufacturers are terrified of Tesla.
- Solar energy production has been on an exponential curve for the last 30 years, but is only now starting to have a big impact. Worldwide, the installation of solar energy has started to exceed that of fossil fuel energy for the first time.
- 3D-printer prices have come down dramatically from US\$18 000 to US\$400 in 10 years. At the same time the process has become 100 times faster. All major shoe producers have started 3D printing shoes, and spare parts for aircraft are already being 3D printed at remote airports where they are needed. New smart devices (smartphones and tablets) are expected to have 3D scanning capabilities soon. It is expected that by 2027, 10% of everything that is being produced will be 3D printed.

Questions

1. Select any three of the expectations mentioned by Gollub and for each one identify the industry or industries that could be affected and/or disrupted should the expectation(s) materialise, and explain how they might be affected.
2. Based on the content of this chapter, identify and discuss the most suitable environmental scanning and environmental analysis method or methods you would consider for each of the three expectations you identified in question 1 to obtain relevant, strategically important information regarding these potential future developments.

The dramatic role of technological advancement cannot be ignored. However, since countries are all at different levels of economic development and technological progress, change will obviously not occur to the same extent and at the same rate in developing countries compared to highly industrialised countries. However, the fact that some of the above-mentioned expectations may not be realised within the expected timeframes, or maybe not at all, is not the question. The real issue here is whether organisations in their respective industries are scanning, analysing, evaluating and monitoring the macroenvironment, and developing suitable scenarios which should enable them to face future challenges better than competitors do by timeously aligning their strategies better than their competitors.

The internet, world wide web and social media have become part of everyday life. World internet users by region as at 30 June 2017 appear in [Table 5.1](#). The growth in internet users over the period 2000 to 2017 has been significantly higher for developing than for developed regions. Growth in internet usage for Africa, the Middle East, Latin America/Caribbean and Asia increased by 8 503.1, 4 364.7, 2 137.4 and 1 595.5% respectively from 2000 to 2017, while internet usage in Europe and North America, for example, increased only moderately by 527.6 and 196.1% respectively over this period.²⁹ These trends undoubtedly reflect unique and challenging investment, trade and marketing opportunities for organisations active in or envisaging international business, especially in developing regions. However, one should keep in mind that growth in internet users in developing regions referred to above typically commences from an extremely low base compared to that in developed regions.

In the recent past, use of the internet required a computer. While this is still the case, new generations of mobile phones and smartphones, as well as iPads, now also allow access to the internet.

Information technology (IT) has become a major financial, operational, and organisational component of organisations' strategies. In most industries, IT:

- neutralises traditional sources of competitive advantage such as size, location, vertical integration and communications technology, in part depending on the industry
- extends organisational reach by targeting multiple markets, domestic and international
- creates virtual marketplaces through the internet and e-commerce
- changes traditional modes of customer interface and distribution, such as online shopping
- greatly enhances knowledge transfer, interorganisational collaboration and networking, domestically and internationally
- is neutral to traditional stereotypes such as gender, ethnicity and age.

Examples of technological developments with vast commercial potential include, but are not limited to, the following:³⁰

- Genetic engineering
- Robotics and continuous advancement in AI
- Computer-aided design and manufacturing as well as 3D printing
- Nanotechnology and its increasing importance in fighting cancer, transforming energy, replacing silicon in microchips, and in space travel
- Genetically modified food products
- Manufacturing of electric and self-driving motor vehicles
- Technological advanced multipurpose drones, including passenger-carrying drones.

Downsides of technological development are seen as, *inter alia*, its contribution to pollution and global warming in certain instances and the impending requirement of retraining and reskilling for new emerging work and careers.

5.4.7 Factors related to the natural environment

An important factor in the macroenvironment is the delicate and often sensitive relationship between business and the ecology or, more specifically, the natural environment. The term 'ecology' refers to the interaction among human beings and other living things, and the air, soil and water in the natural environment that support them. Threats to the life-supporting ecology, caused predominantly by human, but especially industrial and commercial activities, are referred to as environmental degradation.

Global climate changes have been accelerated by humanity's activities. A change in atmospheric radiation, owing in part to ozone depletion, causes global warming. This is caused by solar radiation, which is normally absorbed into the atmosphere, reaching the earth's surface, heating the soil, water and air. Other important issues which ecologists emphasise are the extinction of important flora and fauna, and deforestation, which is occurring at an alarming rate. Air pollution is created by dust particles and gaseous discharges that contaminate the air. Acid rain, basically rain contaminated by sulphur dioxide, which can destroy aquatic and plant life, is believed to result from coal-burning factories in 70% of all cases. A health-threatening 'thermal blanket' is created when the atmosphere traps carbon dioxide, for example emissions from cars and factories. Also, avoiding contamination of water supplies is a major challenge to even the most conscientious of manufacturers. Land pollution is caused by the need to dispose of ever-increasing amounts of waste and, in recent decades, nuclear waste. Routine, everyday packaging is a major contributor to this problem. Land pollution is also caused by the disposal of industrial toxic wastes in underground sites.³¹

Global climate change is a vital issue that can no longer be ignored. One example is motor vehicle manufacturing with implications for global warming largely due to the use of fossil fuels. The introduction of hybrid cars some time ago and the current availability of electric cars have largely served to diminish air and noise pollution. However, the

following Case example on pollution and climate change clearly emphasises the increasing seriousness of authorities to combat climate change and the implications thereof for commerce and industry.

CASE EXAMPLE: CDP – combating pollution and climate change³²

CDP (formerly the Carbon Disclosure Project) is a registered charity headquartered in the UK, with a global reach. Over the past 15 years CDP has created a system for engagement on environmental and climate change issues among investors, companies, cities, states and regions worldwide, where the data gathered by CDP enables these stakeholders not only to make better decisions, but also to measure their performance with regard to decreasing their carbon footprint and combating climate change impacts. In 2017, more than 5 600 companies responded to CDP's climate change, water, forests and supply chain questionnaire. Furthermore, 71 of the world's states and regions now measure their environmental impact through CDP. In this regard, it is commendable that Nedbank in South Africa became Africa's first carbon-neutral financial organisation.

However, of critical importance to South Africa is the Carbon Tax Bill. The Bill provides a more detailed way to quantify carbon emissions released by a company. It also provided clarity on when the Bill would first be implemented. The carbon tax rate was established at R120 per tonne of carbon dioxide equivalent emitted. This will increase annually by the inflation rate plus 2% until December 2022, and thereafter, at the rate of inflation. According to Zelda Burchell, a senior consultant on carbon and energy at Cova Advisory & Associates, the carbon tax will be a tax-deductible expense and a company's carbon tax liability will be based on a number of calculations. While the calculations consider a number of allowances or discounts, which would, *inter alia*, depend on concepts like the 'trade intensity' of the sector, the tax would still have a significant negative effect for carbon- and energy-intensive industries. However, Burchell warned that companies needed to be prepared and be able to accurately quantify their emissions to ensure they would be paying the correct carbon tax.

The above Case example confirms that both the private and public sectors are being held responsible for eliminating the toxic by-products of their manufacturing activities. Customers are becoming increasingly environmentally conscious, and require products and services that are environmentally friendly. Worldwide, environmental legislation impacts corporate strategies, which could be costly, as is evident from this Case example.

However, the natural environment may also exert a significant influence on organisations. In this regard, natural events include earthquakes, landslides, avalanches, floods, tidal waves, droughts, freezes and volcanic eruptions. There are two observations to be made about natural events:

- Their impact upon business activity can be very powerful and, in almost all cases, the events are difficult to predict or avoid.
- The risk of certain natural events occurring varies by geographic location.

Natural influences can occur on a scale from very small to very large. Two natural disasters of massive proportions took place in 2010, when Haiti and Chile were devastated by earthquakes which effectively destroyed entire cities, and hundreds of thousands of people were killed. For businesses affected by natural impacts, the effects can be unexpected, extremely costly and devastating, as is evident in the Strategy in action case below.

STRATEGY IN ACTION: When 'dry white' is not a vintage but a disaster³³



By January 2018, the severe drought in the Western Cape province of South Africa was taking its toll on key industries that constituted the province's mainstay of economic activity. In January 2018, the wine industry, which accounted for 4% of global wine production and was the seventh largest global producer at the time, was bracing

for its smallest harvest in more than a decade. During 2017, the wine industry generated revenues of about R9 billion and recorded a 4% increase in volume to 401 million litres despite concerns that land under tillage was shrinking. The area under vines had been shrinking since 2007, with the total area having declined by 5% between 2011 and 2016. Francois Viljoen, consultation service manager at Vinpro, said the drought that had been prevalent in the province for three consecutive seasons would affect the 2018 harvest, given that most of the industry's large irrigation dams were only 30–40% full, but with rapidly declining volumes. This meant that wine grape producers' water resources were cut by 40–60%, and they could not fully meet their vines' water demand. Vineyards were beginning to show symptoms of water shortage and declining berry growth, a lighter harvest, lower juice levels and thus lower volumes, resulting in higher prices. Economic observers said that other economic sectors in the Western Cape, such as tourism, fruit farming and horticulture, would similarly take a knock from the drought. Losses in revenue were expected to run into millions of rands. Even more profound socio-economic effects were expected from the drought. In the third quarter of 2017, South Africa's agricultural sector saw 25 000 job losses, with the Western Cape accounting for 84% of them. Total job losses in 2017 numbered 109 000. The drought was also seen as an imminent concern for farmers who ran the risk of losing their farms due to debt caused by low production volumes and a long road to recovery. Interestingly, the yields of other wine-producing countries, among them France, Italy, Spain and the US, had also been affected by natural phenomena.

Questions

1. How important is the natural environment as a macroenvironmental factor that business organisations need to consider from a strategic perspective?
2. Discuss the merits of scenario analysis and planning as an 'environmental forecasting method' for assessment of possible climate change in the agricultural sector.

In the section that follows we conclude our overview of the external environment by looking at factors and forces related to the global business environment.

5.4.8 Factors related to the global environment

Organisations worldwide have become increasingly involved in international business mainly through exporting, expanding operations to foreign markets by means of foreign direct investment, licensing, and the formation of international joint ventures and strategic alliances. The increasing trend in international involvement by multinational enterprises has undoubtedly enhanced the ongoing process of globalisation. Globalisation has been largely facilitated by declining barriers to international trade and investment, and generally made possible by significant advances in technology – especially in communications and transportation technologies.³⁴ To compete internationally, organisations need to adopt viable international competitive strategies, which are discussed in [Chapter 11](#).

According to Hill (2014), **globalisation** refers to the shift away from distinctive national markets towards a more integrated and interdependent world economy.³⁵ Globalisation accordingly provides the context for the strategic analysis of the external business environments – at both macro- and industry levels of the countries in which the organisations operate, or in which they are contemplating international involvement. This involves analysis of the macroenvironment in terms of political-legal, economic, sociocultural, demographic, technological and natural environmental factors, including factors related to the global environment that may impact on countries, industries and their organisations.

As stated in [section 5.3](#), forces in the global environment will not affect macroenvironmental and industry factors in all countries in exactly the same way and to the same extent. For example, the global financial crisis that emerged in 2008 and continued well into 2010 did not affect the financial sectors in all countries to the same degree. Financial institutions in a number of developed countries, in particular those with high-risk exposure to specific

products such as sophisticated financial instruments and unsecured mortgage bonds, were affected much more seriously than those in other, mostly developing countries with much less risk exposure. As a result, it seems that some emerging economies, including South Africa, weathered the storm much better than most developed economies.

Owing to ongoing globalisation and increasing international competition, purely domestic organisations have to analyse the macro- and industry environments in their home country and the potential effects of possible global forces. Organisations involved in international business, however, also have to analyse and evaluate the macroenvironmental and industry factors and forces for each one of the countries with which they do business.

While we use the same six macroenvironmental factors to assess the global environment, the forces related to them are bound to differ profoundly in emphasis as well as impacts when compared to the same forces in an organisation's domestic macroenvironment. In this regard, [Table 5.2](#) illustrates typical domestic environmental factors and forces which could, however, also be appropriate for analysing the environments of other countries, but allowing for country differences. Following is a brief exposition of the main factors to be analysed in a global context:

- *Economic factors* are the differences in economic systems (whether free market, mixed or command economies), levels of economic development, economic growth rates, per capita income levels and disposable income levels, monetary and fiscal policies, interest rate and inflation rate levels, wage levels and extent of exchange controls need to be evaluated, *inter alia*, to determine country attractiveness for international involvement.
- *Political factors* include political ideology, political systems (whether democratic, totalitarian or theocratic), form of government, degree of political stability, political risk, government attitude towards foreign business organisations, competition policy and ease of doing business.
- *Legal factors* include legal traditions, legal systems (whether common law, civil law or theocratic legal systems), existence of the rule of law or otherwise, effectiveness of legal systems, extent of protection of intellectual property, treaties with other countries, and whether repatriation of profits and dividends to the parent country is allowed.
- *Sociocultural factors* include differing customs, norms and values, lifestyle, language, literacy levels, religious beliefs and attitudes, levels of education, social unrest, frequency of strikes, and levels of crime, corruption and fraud.
- *Technological factors* include levels of technological development and infrastructure, availability of technological skills, and the extent and government support of research and development (R&D).
- *Demographic factors* refer to population size, age structure, gender, income levels, lifestyle and leisure, as well as rate of urbanisation and other demographic shifts.
- *Natural environmental factors* include the abundance of natural resources, climate, availability of energy and water, degree of air pollution regulations, and the extent of waste management and recycling.

While some 'domestic' and 'global' factors or forces may seem similar, organisations need to analyse and evaluate them separately and individually for each country in which they are involved or envisage such involvement. This applies specifically where these factors or forces relate to and could influence country attractiveness, industry attractiveness and competitiveness, market size and market potential for an organisation's products and services. Deciding on international competitive strategies, based on sound strategic analysis, is discussed in [Chapter 11](#).

5.4.9 Relationships among factors of the macroenvironment

Thus far we have only referred briefly to interrelationships between the various elements or factors of the macroenvironment. In [section 5.3](#), the potential impact of changes in the international oil price on the vehicle manufacturing industry, on ecological issues such as pollution, and energy as a scarce resource were identified. Likewise, the demographic issue of ageing populations was seen to hold implications for industries or sectors which

include social security, healthcare, retirement funds, retirement housing, and possibly leisure, recreation and tourism, where the latter could in turn present an opportunity to the hospitality industry, locally and internationally, transportation in general and the commercial passenger airline industry in particular. The discussion in [section 5.4.4](#) clearly indicated that HIV/AIDs as a sociocultural factor has economic, social and demographic implications. Again, technological factors such as advances in technology could improve productivity, resulting in lowering the inflation rate (an economic factor). An increase in interest rates could decrease the demand for residential houses, which would affect the building and construction industries, as well as the loan and mortgage divisions of financial institutions. However, notwithstanding the typical relationships between macroenvironmental factors outlined above, and taking a more future-oriented, strategic perspective, a question could be which macroenvironmental factors as well as industry considerations would possibly be relevant once 'flying taxis' become a commercial reality?

Effects of or trends in macroenvironmental factors could vary from global to regional and national, and also across industries within countries, once again affecting organisations through the effect on their industries. For sustainable competitive advantage, management should be acutely aware of and well informed about existing as well as envisaged macroenvironmental changes.

5.4.10 Summary

In this section we explored the more important macroenvironmental factors and forces, both globally and within countries, and their characteristics and potential impact on industries and organisations within industries. Information obtained from analysing these factors and forces is of vital importance for sound strategy formulation as part of an organisation's strategic management process. In the sections that follow, selective methods for analysing the macroenvironment are investigated.

5.5 Analysis of the macroenvironment

5.5.1 Introduction

As forces in the external environment change, organisations need to know how to reconfigure or adapt their strategies to remain competitive. They therefore need to continuously scan the external environment (macro- and industry environments at global, regional and country levels) to identify emerging opportunities and threats. Managers who developed a keen awareness of and are alert to actual and potential macroenvironmental changes, and are able to predict the possible impact of these changes on their industries and markets with a high degree of certainty, can be regarded as a source of competitive advantage. In the sections that follow we first explore the characteristics and impact of environmental turbulence, and then discuss selected techniques to assess an organisation's macroenvironment.

5.5.2 Assessing macroenvironmental turbulence

According to Lynch (2006),³⁶ the environmental turbulence that organisations face can be assessed by means of the following two measures changeability and predictability.

- *Changeability* is seen as the degree to which the macroenvironment, or segments of it, is likely to change. For example, changeability in the market for food products such as milk and bread is low, reflecting low changeability, whereas the market for mobile phone handsets, characterised by rapid and continuous technological improvements, reflects high changeability.

As a further refinement, changeability is seen as comprising of two components: complexity and novelty.

Complexity is viewed as the degree to which an organisation's macroenvironment is affected by complex external

factors such as continuing globalisation and rapid technological, social and political change. Novelty involves the degree to which the macroenvironment presents an organisation with new situations and unique opportunities, as in the case where technology has created the opportunity and made it possible to use drones to deliver medicines to clinics in the mountainous areas of Rwanda.

- *Predictability* involves the extent to which macroenvironmental change can be predicted. For example, change can be predicted with some certainty in the motor vehicle market, reflecting high predictability, but it is extremely difficult, if not impossible, to predict change in areas such as biogenetics and AI, reflecting low predictability. Predictability can also be further subdivided into the rate of environmental change, either rapid or slow, and visibility of the future. In terms of 'visibility of the future', for example, the availability and usefulness of information for long-term weather forecasting in particular is low. This is because the information becomes increasingly uncertain and, as a consequence, less useful the further into the future one goes. Weather forecasts, especially long-term ones, are of critical importance for the agriculture industry.

Based on these considerations, it is possible, to categorise and assess changeability and predictability in relation to states and degrees of macroenvironmental turbulence. Given the industry in which an organisation operates – high or low changeability, and high or low predictability – it is assumed that management would be aware of the type of turbulence it faces and which macroenvironmental analysis techniques would be most suitable to assess turbulence. This brief outline on macroenvironmental turbulence accordingly provides a point of departure to analyse the macroenvironment for a specific organisation from the perspective of the industry in which it operates. In the discussion below, we first explain how macroenvironmental analysis could be approached, and follow it with a discussion of a number of frequently used techniques for macroenvironmental analysis.

5.5.3 A guideline for macroenvironmental analysis

As one approach to macroenvironmental analysis, Lynch proposes a nine-stage process to analyse the external environment as outlined below.³⁷ Note that stages one and two relate partly to all organisations, irrespective of the industries in which they are involved, while the remaining seven stages relate to a specific industry, and hence to organisations in it:

- *Stage 1:* Environment basics. An initial evaluation to define and explore the basic characteristics of the environment including market size, market share and market growth. The outcome of this stage is an attempt to define the strategic market scope, future growth prospects, and market competition for the organisation.
- *Stage 2:* Consideration of the degree of turbulence in the environment. General considerations including whether change is fast or slow, repetitive or unique, unpredictable or forecastable, and whether these changes will exert simple or complex influences on the organisation.
- *Stage 3:* Background factors that influence the competitive environments. Consideration of background factors that influence the competitive environment, such as the macroenvironmental factors listed in [Table 5.2](#) as well as emerging scenarios, to identify opportunities and threats, and the predictability of these macroenvironmental variables.
- *Stage 4:* Analysis of the stages of market growth. Analysis of the stages of market growth as they relate to the industry life cycle to identify the growth stage in which the industry and hence the organisation finds itself.
- *Stage 5:* Factors specific to the industry. Analysis of success factors specific to the industry to identify those factors relevant to strategy development for the organisation.
- *Stage 6:* Factors specific to the competitive balance of power in the industry. Analysis of factors specific to the power balance in the industry, based on a Five Forces industry analysis in an attempt to identify these factors within the industry.

- *Stage 7:* Factors specific to cooperation in the industry. Analysis of factors specific to cooperation in the industry by identifying current and future organisations for potential networking and cooperation.
- *Stage 8:* Factors specific to immediate competitors. Analysis of factors specific to immediate competitors by means of competitor and product portfolio analyses, competitor profiling, and analysing the relative market strengths of competitors.
- *Stage 9:* Customer analysis. Analysis based on market segmentation studies to develop strategies targeting existing and potential customers.

Table 5.2 Basic stages in environmental analysis³⁸

Stage	Techniques	Outcome of stage
1. Environment basics – an opening evaluation to define and explore basic characteristics of the environment	Estimates of some basic factors surrounding the environment: • Market definition • Market growth • Market share	Basic strategic analysis of: • Scope the strategic opportunity • Establish future growth prospects • Begin to structure market competition
2. Consideration of the degree of turbulence in the environment (section 5.5.2)	General considerations: • Change: Fast or slow? • Repetitive or surprising future? • Forecastable or unpredictable? • Complex or simple influences on the organisation?	General strategic conclusions: • Is the environment too turbulent to undertake useful predictions? • What are the opportunities and threats for the organisation? (section 5.5.4.1: SWOT analysis)
3. Background factors that influence the competitive environments	PESTEL analysis and scenarios (sections 5.5.4.1 and 5.5.4.5)	• Identify key influences • Predict, if possible • Understand interconnections between events
4. Analyse stages of market growth	Industry life cycle (section 6.2.4)	• Identify growth stage • Consider implications for strategy • Identify maturity, overproduction and cyclical issues
5. Factors specific to the industry	Key factors for success analysis (section 6.2.2)	• Identify factors relevant to strategy (section 8.4) • Focus strategic analysis and development
6. Factors specific to the competitive balance of power in the industry	Five Forces analysis (section 6.2.3)	• Static and descriptive analysis of competitive forces (section 6.2.4)
7. Factors specific to cooperation in the industry	Four Links analysis – analysing the extent of cooperation with others	• Analysis of current and future organisations with whom cooperation is possible • Network analysis
8. Factors specific to immediate competitors	Competitor analysis and product portfolio analysis (section 6.3)	• Competitor profile (section 6.3) • Analysis of relative market strengths
9. Customer analysis (section 6.3)	Market and segmentation studies	• Strategy targeted at existing and potential customers (section 6.3)

For the analysis and evaluation of an organisation's macroenvironment, a number of widely used techniques are briefly discussed in the following sections.

5.5.4 Conducting macroenvironmental analysis

5.5.4.1 SWOT analysis

Over time, the **SWOT analysis** method has been a popular approach to analysing the external environments of organisations. SWOT is an acronym for strengths, weaknesses, opportunities and threats, where strengths and weaknesses relate to internal organisational factors, and opportunities and threats relate to external environmental factors. In this approach, a list of the organisation's strengths and weaknesses is innovatively and appropriately matched with concomitant environmental opportunities and threats, with the purpose of enabling organisations to focus on their strengths, avoid their weaknesses, capitalise on opportunities and counter threats in terms of their strategic planning.

Examples of selected macroenvironmental factors and forces appear in [Table 5.3](#). Keep in mind that a macroenvironmental factor, for example an economic factor, has implications known as forces, for example inflation, volatile exchange rates, etc. Internal factors are discussed in [Chapter 7](#). The list of external factors is not exhaustive, but merely serves as an indication of the sources of information which, if relevant, should be considered and preferably included for purposes of macroenvironmental analysis and strategy formulation.

Despite its popularity, SWOT analysis has a number of shortcomings that largely limit its usefulness. First, it is a static representation of identified external factors, and unless it is combined with a technique like scenario analysis it has little bearing on the future for strategic planning purposes. Second, it is imperative that identified SWOT factors be prioritised to ensure that maximum impact and benefit are derived from the matching of internal and external factors. Prioritisation will also enhance the optimal allocation of resources. The combination of external and internal factors to produce a SWOT matrix is presented in [Chapter 7](#).

5.5.4.2 The PESTEL approach

The macroenvironment consists of six external variables, known by the acronym **PESTEL**, which represents political, economic, sociocultural, technological, ecological and legal variables. The PESTEL analysis involves the identification of macroenvironmental factors for organisations. As stated before, organisations use information from **macroenvironmental analysis** to develop or adapt their strategies to minimise the effects of threats, and capitalise on opportunities. Unlike the broad list of environmental factors and forces provided in [section 5.5.4.1](#) and [Table 5.3](#), which merely serve as a guideline to consider, the management of organisations requires information regarding potential opportunities and threats specific to their organisation. The PESTEL approach provides a useful way of identifying factors and forces that are relevant to the organisation within the industry in which it operates. For example, the PESTEL approach for a commercial airline within the commercial airline industry can be structured as illustrated in [Table 5.4](#) to obtain specific information on the following macroenvironmental factors and forces.

Table 5.3 Examples of macroenvironmental factors and forces

Political-legal • Political stability • Regulation/deregulation of industries • Trade policies – incentives and disincentives • Competition policy • Tax laws • Exchange controls • Labour legislation • Protection of intellectual property rights • Legal system/rule of law • Government bureaucracy	Economic • Economic growth – GDP and GNP • Monetary and fiscal policies • Level of interest rates • Level of inflation • Levels of disposable income • National debt levels • Foreign direct investment • Tax systems and tax rates • Import/export factors • Infrastructure – utilities, transportation and distribution • Employment and unemployment rates
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Sociocultural • Culture – values, beliefs, norms, religion • Women in the workplace • Lifestyle changes • Social welfare, healthcare and housing • Structure and diversity of society • Transmittable diseases, e.g. HIV/Aids • Levels of education • Language and levels of literacy • Levels of crime, corruption and fraud • Ageing populations	Technological • Levels of innovation and especially product innovation • Levels of technology adeptness and productivity • Robotics and AI • Technology transfer • Government spending on R&D • E-business, internet marketing and online shopping • General ICT levels in commerce and industry • Technological literacy • Telephony, internet and wireless proficiency • Cloud computing and other advanced IT applications
Natural environment/ecological • Levels of pollution • Environmental protection laws • Waste management • Water recycling • Deforestation • Water pollution • Air pollution • Carbon footprints • Global warming • Ozone depletion	Demographic • Population size and growth rates • Mobility and migration • Extent and rates of urbanisation • Age distribution • Gender distribution • Religious orientation • Income levels • Consumer behaviour • Consumption patterns • Geographic distribution

Table 5.4 PESTEL – examples of macroenvironmental opportunities and threats³⁹

Political • Government intervention and support for national carriers • Security requirements and controls • Effects of existing international airline treaties	Economic • Interest and inflation rate levels • Economic growth rate • Exchange rates (especially in terms of the procurement of fuel) and fuel prices
Sociocultural • Increase in travel by the elderly • Increase in tourist and student air travel • Multilingual cabin crews	Technological • Fuel-efficient engines and airframes • High-technology security equipment • Teleconferencing for business class passengers
Ecological (natural environment) • Air and noise pollution controls • Energy consumption controls • Noise pollution controls	Legal • Landing and preferential airport rights for airlines • Restriction on airline mergers • Increase in domestic and International safety regulations

The list of factors or forces highlighted in the example provided in this table is not exhaustive, and organisations have to identify and consider all factors relevant to their own organisations. From a strategic perspective, further analysis of the potential impact or effects of identified factors or forces is imperative to determine the extent and, where possible, also the timing of any potential impact that could occur. While PESTEL analysis is extremely useful, it should be kept in mind that it only provides information at a specific point in time. However, the future impact of identified factors and forces are of greater importance for effective strategy formulation.

Accordingly, when interpreting the outcomes of PESTEL analysis, management should be acutely aware of the following:

- As stated above, PESTEL factors or forces are ‘static’ and therefore only present a starting point for unravelling the future implications of these factors.

- The identified macroenvironmental factors should not be seen in isolation, but the implications of various factors could be interlinked, for example technologically advanced fuel-efficient engines (technological and economic factors) also exhibit lower air and noise pollution levels (natural environmental factor).
- PESTEL analysis combined with scenario analysis (see [section 5.5.4.4](#)) and planning may provide superior strategic information which could contribute to the organisation's competitive advantage.

The PESTEL approach, as stated, should lead to more extensive and detailed analysis of relevant macroenvironmental factors or forces. Key to the process is identifying strategically important issues expected to have an impact on the industry and the organisation concerned, especially with a view to the future.

5.5.4.3 The issues priority matrix

Organisations are bound to respond differently to the same environmental changes because of differences in the ability of managers to recognise and understand external strategic issues and factors. Few organisations can successfully monitor all potentially important external factors. Even though managers agree that strategic importance determines what variables are consistently tracked, they sometimes miss or choose to ignore crucial new developments. Personal values of an organisation's managers and the success of current strategies are likely to bias both their perceptions of what is important to monitor in the external environment as well as their interpretations of what they perceive. This is known as **strategic myopia**, an embedded personal tendency to reject unfamiliar and especially negative information. Organisations therefore may not be gathering the appropriate, vitally important external environmental information necessary to adapt or change strategies successfully, resulting in declining competitiveness at best, and complete failure at worst. One way to identify and analyse strategically important developments in the macroenvironment is to use an **issues priority matrix** as described below, using the framework outlined in [Figure 5.2](#). An issues priority matrix is an approach that simultaneously assesses the extent of both the probability of a macroenvironmental event occurring and the extent of its probable impact on an organisation.

- Identify a number of likely key trends emerging in the macro- and industry environments using a technique such as the PESTEL approach. These are strategic environmental issues: those important trends that, if they happen, will determine how various industries might be affected, what they will look like, and what strategic responses could be required.
- Assess the probability (from low to high) of these trends actually occurring.
- Attempt to ascertain the likely impact (from low to high) of each of these trends on the organisation.

There are three possible ratings in the issues priority matrix, namely low, medium and high. The issues priority matrix can be used to help managers decide which environmental trends should be merely scanned (low priority) and which should be monitored as strategic factors (high priority). Important external strategic factors of an organisation are those environmental trends that are judged to have both a medium-to-high probability of occurrence and a medium-to-high probability of impact on the organisation. As an example to illustrate the application of this approach, consider the 'sugar tax' that the South African government has legislated. For a company manufacturing sugar-based beverages, the probability of the legislation being introduced appeared to be high, despite objections raised by that industry and other related ones. The probable impact on this specific sector is also regarded as high in terms of increased cost to the consumer, which could adversely affect demand for such products and, in turn, sales and profitability. This macroenvironmental factor will obviously have no consequences for industries that do not use sugar. All relevant environmental trends judged to be of specific importance to the organisation are then categorised as potential opportunities or threats. This approach could be supplemented by scenario analysis and planning for a more comprehensive outcome. The value of the issues priority matrix is that it allows organisations to pre-emptively adapt their strategies better than competitors do. We now look at scenario analysis and planning in the section that follows.

Figure 5.2: Issues priority matrix⁴⁰

		Impact on organisation	
		High	Low
Probability of occurrence	High	High priority	
			Medium priority
	Low		Low priority

5.5.4.4 Scenario analysis and planning

Owing to the general increased pace of change in the external environment, it is reasonable to assume that over time most organisations will have to face increasing rather than decreasing levels of uncertainty and complexity (refer to [section 5.5.2](#)). It has thus become imperative that management adopt an innovative approach to strategic thinking and strategic analysis to generate a dynamic, future-orientated view of evolving environmental change. **Scenario analysis and planning** is an extremely useful approach in understanding future-orientated macroenvironmental industry and competitive dynamics and change, providing plausible alternative views of how the business environment of an organisation might develop in future. (See [section 4.5.2.3](#).)

Scenarios, scenario analysis and scenario planning concern the medium- to long-term future and embrace the possibility of pre-emptively providing foresight regarding possible future change. According to Hill et al., scenarios offer plausible alternative views of how the business environment of an organisation might develop in future.⁴¹

Accordingly, scenario analysis is the identification and structured investigation of possible future configurations of the wider business environment at both global and individual country levels through consideration of political-legal, economic, sociocultural, demographic, technological and ecological factors.⁴² According to Ringland, 'scenario planning is that part of strategic planning which relates to the tools and technologies for managing the uncertainties of the future.'⁴³

Scenario planning involves the development of 'what if' plans with regard to a range of possible alternative futures based on different strategic assumptions. Scenario planning therefore is essentially an innovative approach to get managers to be alert to and understand the dynamic and complex nature of the external environment, to think strategically and to generate a range of strategic options that could be pursued under different circumstances and varying envisaged environmental conditions, as illustrated in the following Case example of Shell Oil Company.

CASE EXAMPLE: Scenario planning and analysis – Shell Oil Company⁴⁴

Scenario planning has proved its usefulness in coping with strategic uncertainty over the medium- to long-term. Scenario planning has essentially proved to be superior to trend analysis, extrapolation of past occurrences, or the popular high and low forecasts of future events often used in strategic planning.

The Shell Oil Company has pioneered and refined the business application of scenario planning since the 1960s, and especially during the more turbulent and volatile period from 1970 onwards. Shell combined strategic information and innovative assumptions about possible futures to create plausible scenarios.

'The result of the 1973 oil embargo was a sharp increase in crude oil prices, short supplies of gasoline for consumers, and a depressed world economy.'⁴⁵ Shell's strategic planning division at the time suggested that 'a more unstable environment was coming, with a shift of power from oil companies to oil producers.'⁴⁶ Based on this foresight, Shell took precautionary actions, and as a result was in a far better position than most other oil companies when the 1973 oil embargo occurred. Shell's strategic assumptions about the future and their scenarios led to major new oil field investments to minimise the risk of total dependence on the oil producers.

Shell's scenario-planning process involved the following stages:

- Extensive open-ended interviews with people and experts both inside and outside the industry
- Analysis of interview information by issue, to build an 'agenda' of potential expectations
- Synthesis of each agenda to identify underlying areas of uncertainty and possible interrelationships among issues
- Workshops to explore key issues to understanding and identifying gaps for further research
- Building a small number of scenarios that may occur over an identified future period of five to 10 years or longer – Shell developed scenarios 20 years into the future
- Testing strategy options against the scenarios to assess the effectiveness of strategies under more than one scenario.

Shell's strategies based on their scenarios aided them to cope with rising oil prices after 1973. While expectations generally were that the oil price would just keep on rising, one of Shell's scenarios at the time was based on the strategic assumptions of a drop in the oil price. In 1984, crude oil was at US\$28 a barrel (up from US\$3 in 1973). In February 1986, the oil price dropped to US\$17 a barrel, and was at US\$10 two months later. Shell, however, was prepared for this and when it happened, adapted its strategies to investigate alternative sources of energy and renewed its fleet of oil tankers, while its competitors' strategies were based on continued rising oil prices. During the 1980s, Arie de Geus and Pierre Wack had developed scenario planning at Shell to a fine art.

According to Grant, Shell prepares its global scenarios about every four years, where economic, political, technological and demographic trends are explored 20 years into the future, with their 2005–2025 scenarios based on three sets of forces: market incentives, community, and coercion and regulation, as well as on three objectives: efficiency, social cohesion and security.⁴⁷

As already stated, a major benefit of scenario analysis and planning is that it avoids the limitations of traditional planning methods such as simple forecasting, trend analysis and extrapolation methods which at best are only appropriate in cases of short planning horizons, a limited number of variables, and relatively low risk levels. This implies that traditional single-point forecasts can no longer provide reliable medium- or long-term data in dynamic and uncertain external environments.

Scenario analysis and planning can also aid decision-making by providing managers with unique insights regarding possible future environmental change. Schoemaker⁴⁸ concurs, stating that 'scenario planning enables managers to compensate for two common errors in decision-making: the under-prediction or over-prediction of change. Scenario planning allows charting a middle course between under- and over-prediction, expands the range of possibilities, and prevents management from drifting into unbridled science fiction.' Scenario planning makes this possible by dividing management's knowledge into the following two areas: (1) things they believe they know something about; and (2) elements they consider uncertain or unknowable.

The first area takes account of the past, recognising the existence of continuity, while the second area provides the major challenge, requiring management to make a judgement about the degree of certainty or uncertainty involved.

Scenario planning, which involves the structured use of managerial judgement to develop and capture multiple possible futures for an organisation, should provide direction for and enhance the quality of an organisation's strategies and action plans, as is aptly reflected in the Case example *Scenario planning and analysis – Shell Oil Company*.

The following guidelines for scenario analysis suggested by Thompson⁴⁹ as far back as 2001 are still relevant today:

1. Clarify key external strategic issues which are likely to impact on the future that the organisation could face.
While managers internally would already have their own views that might be subjective and partial rather than objective and future orientated, and which provide the basis for current operations, it is imperative to also consult experts outside the organisation. Three types of issues must be considered:
 - » Predetermined elements – for example social change such as size, structure, lifestyle and values of the population
 - » Key uncertainties – potential political change and the economic change that usually follows
 - » Driving forces – developments in critical areas such as technology and education.
2. Identify and examine a number of possible outcomes related to and based on strategic assumptions regarding the various key issues – keeping in mind the importance of debating both positive and negative implications of issues, as well as the impact of interconnectedness between them. The outcome should provide some degree of consensus as well as the priorities in terms of plausible scenarios that can be tested further. This stage of the analysis should generate creativity and enthusiasm. The test will require answers to the following questions:
 - » What has been omitted or overlooked? This questions the extent and comprehensiveness of the analysis.
 - » Is everyone in the organisation committed to the outcomes and do the generated scenarios provide a clearer understanding that will more effectively inform future decisions and actions?

In scenario analysis, preferably four plausible alternative scenarios should be considered. Managers should develop strategies across the full range of scenarios, otherwise much of the opportunity for strategic thinking will be lost. The real value of developing scenarios does not lie in the planning process, but rather to challenge and change the mental models and existing assumptions of decision-makers.⁵⁰

In closing, sound scenario analysis and planning as part of strategy formulation will undoubtedly contribute to sustainable competitive advantage in conditions of unpredictability and change.

5.5.4.5 The benefits of macroenvironmental analysis

Macroenvironmental analysis has real or potential benefits for an organisation, which could include the following:

- It increases managerial awareness of environmental changes.
- It increases understanding of the context in which industries and markets function.
- It improves understanding of relevant multinational and global issues.
- It helps improve resource allocation decisions based on strategic priorities.
- It enables management to identify and reduce risk due to a greater awareness and understanding of potential environmental threats.

Macroenvironmental analysis accordingly focuses attention on the importance of actual and potential strategic change, particularly during the environmental scanning process, and acts as an early warning system that allows management to identify emerging opportunities and threats, and to devise appropriate and timeous responses in this regard.

5.5.4.6 The limitations of macroenvironmental analysis

The macroenvironment can be extremely complex, and at any one time there may be conflicting and contradictory changes taking place. Also, the pace of change in many macroenvironmental forces is increasing, with the environment becoming more turbulent and unpredictable. Increasing change and uncertainty have, to some extent, cast doubt on the value of conducting macroenvironmental analysis at all. Some argue that by the time an organisation has come to terms with one major change in the macroenvironment, another change often occurs that requires even more attention and action. However, an approach of 'emergent' instead of 'deliberate' strategising would largely overcome this concern.

Accordingly, managers who are concerned with strategic analysis must:

- be aware of the limitations of macroenvironmental analysis since industries differ in terms of both their degree and rate of change as well as the unpredictability of such change
- understand the complexity of the environment in which they operate and the sources of information on which the analysis is based
- conduct analysis continuously (because changes occur frequently)
- constantly seek to identify more appropriate sources of information and techniques for analysis
- use the information as one source of organisational learning (alongside other information-gathering activities)
- use the information to inform future strategy.

However, the advantages of macroenvironmental analysis far exceed any potential disadvantages. If approached correctly, the effect of limitations can be minimised or even avoided. Macroenvironmental analysis remains an invaluable means of increasing the strategic awareness of managers regarding the environments in which they operate and must compete.

5.5.5 Summary

In this section we focused on a number of approaches to the analysis of the external environment. More specifically we considered the analysis of environmental turbulence, explained the PESTEL approach, issues priority matrix and scenario analysis and planning approaches to macroenvironmental analysis.

5.6 Summary

The macroenvironment comprises external factors that typically affect all organisations. Changes in the macroenvironment are of extreme importance to organisations since they are bound to influence market expansion or contraction, determine the level of competition within an industry, and identify potential technological advances that could lead to the creation of new industries or the demise of existing ones. These macroenvironmental changes can be evaluated using PESTEL analysis to identify trends in political-legal, economic, sociocultural, technological, ecological and legal factors and forces. Managers can then create an issue priority matrix to classify environmental trends as low, medium or high in terms of probability of occurrence and their impact on an organisation's strategy. Another important approach to macroenvironmental analysis is **scenario analysis**. Management can use this technique to clarify issues, identified in a PESTEL analysis, which may impact on the future of the organisation. The outcomes from this analysis need to be evaluated in terms of the likelihood of their occurrence and potential impacts on the future of the organisation. Recommendations on how to deal with each possible impact then follow. Resources required for each recommendation need to be identified to enable its implementation. The purpose of these analyses is to highlight potential opportunities on which to capitalise, or identify potential threats to be minimised, depending on the strategy that management chooses to pursue.

Macroenvironmental analysis should be a continuous process. Managers need to be vigilant in identifying and observing changes in the macroenvironment and adjusting an organisation's strategies accordingly. They need to consider all aspects of the environment which might include factors that do not normally affect the organisation. It

is critical for an organisation to be future-orientated and anticipate environmental change. This could determine success or failure in the choice and implementation of the organisation's strategies.

REFLECTION BOX:

How would you view the major changes in the global business environment related to each of the macroenvironmental factors highlighted in this chapter over the next 30 years – political-legal, economic, sociocultural, technological, demographic and the natural environment? Also, do you think the impact of these changes would be the same for developing countries as for developed countries from a global business perspective?

Hint: Refer to the following video clip to stimulate your reflection: The world 2020–2050

<http://www.youtube.com/watch?v=rU2iTUeCfkl> [Accessed 30 January 2018]

Opening case study questions

1. Why should MTN scan the global business environment as well as the macroenvironments of Angola and Ethiopia prior to their decision to expand operations to these two countries?
2. Identify, prioritise and discuss the major macroenvironmental factors related to both Angola and Ethiopia relevant to MTN. Explain why these factors are important to MTN.
3. Apart from information derived from analysis of the macroenvironmental factors that you identified and discussed in question 2, what other information would enhance MTN's decision-making to expand to Angola and Ethiopia? Provide examples to support your answer.
4. Based on your answers to the questions above, summarise your findings and recommendations regarding MTN's decision to expand to Angola and Ethiopia in a report to MTN's management.

Discussion questions

1. Why is the analysis of macroenvironmental factors and forces of such importance in strategic management? Support your answer with practical examples.
2. Identify relevant political-legal, economic, sociocultural and technological trends that have a significant impact on the South African agricultural industry, and discuss the strategic implications of the identified trends for South African commercial farmers.
3. Critically discuss the following statement: 'Major environmental opportunities and threats usually result from interaction among key environmental trends rather than from a single external environmental factor or event.' Do you agree with this statement? Explain your answer.
4. From a strategy perspective, why is assessment of changeability and predictability of an organisation's business environment of such importance? Analyse and evaluate changeability and predictability of environmental turbulence for organisations involved in the platinum mining sector compared to the consumer retail sector.
5. Apply the PESTEL approach to identify the relevant macroenvironmental factors that a prospective low-cost airline intent on entering the South African domestic airline sector needs to consider, and explain the implications of each of the identified factors in a brief report to the company's management.

Using knowledge and skills

The following exercise should be useful in identifying important sources of external information. A key requirement when preparing an analysis of the external business environment is to use one or more search engines to access relevant published sources of information on political-legal, economic, sociocultural, demographic, environmental, technological and competitive trends and events in the external environment. External opportunities and threats need to be identified and evaluated before strategies can be formulated effectively.

Instructions

- Step 1:** Select a company or business of your choice. Conduct an external analysis for this company. Identify opportunities and threats from information in appropriate sources such as recent company reports, including annual reports, media articles and special reports on the company.
- Step 2:** List five opportunities and five threats that this company faces. Be specific in stating each factor and provide reasons for your choice.
- Step 3:** Include a bibliography of your sources of information.
- Step 4:** Share your information with the management of the company or business in a pre-arranged interview. Obtain information to enhance insight and support your analysis and findings.
- Step 5:** Write a three-page report on your findings and submit it to your lecturer.

Further reading

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Suggested websites

The following websites contain comprehensive information on various international, regional and national environments and strategic issues:

- Business Day* (<http://www.businessday.co.za>)
- CIA World Factbook* (<http://www.cia.gov>)
- Economist* (<http://www.economist.com>)
- Financial Mail* (<http://www.financialmail.co.za>)
- Finweek* (<http://www.netwerk24/finweek.co.za>)
- International Monetary Fund (<http://www.imf.org>)
- Internet World Stats (<http://www.internetworldstats.com>)
- Transparency international (<http://www.transparency.org>)
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CHAPTER 6

Analysing the industry environment

Peet Venter

LEARNING OUTCOMES

After reading this chapter, you should be able to:

- explain what the term 'industry' means
- define the boundaries of an industry for analysis
- identify industry key success factors in different industry settings
- conduct an analysis of the competitive forces in an industry and identify their impact on competition and profitability
- apply the industry life cycle to an industry and identify the impact on industry dynamics and strategy
- explain how a competitor analysis can be conducted
- explain how strategic group analysis can be used to analyse competition in an industry
- explain how a customer analysis can be conducted and its impact on competition and strategy.

KEY TERMS

bargaining power
complementor
cost leadership
differentiation
end-game strategies
industry
industry life cycle
key success factors
market
market segments
new entrants
strategic group
substitutes



The automotive industry of the future: Are car manufacturers ready for it?¹

The global automotive industry is changing, and not all of it is good news for traditional automakers and their supporting industries. Car manufacturers are already conceding that change is required. Early in 2018, North America CEO of BMW, Ludwig Willisch, said: 'With the introduction of every new model, there will be a plug-in hybrid version of that, too.' But this strategy may be too little too late, as the industry is facing fundamental challenges to the way it has always done business.

Car design

Most car manufacturers are still bound to the fossil fuel engines that the industry was built on, and while hybrid engines are a step in the right direction, the future seems to lie with electric cars. However, the key players in this industry are not necessarily the traditional car manufacturers, but seem to come from other sectors, with Tesla (energy) the most notable new entrant to the car market, achieving a great deal of success with its earlier models, such as the Tesla S. Other key players are poised to enter the market, with Google (Waymo project) and Apple (Titan project) both working on electric cars.

Driverless cars are also further threatening the automotive industry as we know it, with McKinsey expecting that they will become mainstream between 2020 and 2040. While the cost of driverless cars is currently prohibitive, this is a problem that new-generation technology companies such as Tesla, Apple and Google are arguable better poised to solve than traditional automakers such as Ford and Toyota.

Impact on related industries

If the changes in car design we explored here come to fruition, this will also have a profound effect on the supporting industries and those who currently benefit from it, as it will mean a move away from an oil-based economy. For example, if the batteries can be charged wirelessly as electric cars are driven in a 'charging lane' (using dynamic wireless charging), service stations may become a thing of the past.

Driverless cars may have a noticeable impact on the income of governments, as the issuing of fines may become yet another victim of profound industry change. Currently in most countries car licence fees are based on emissions. As this becomes irrelevant, it will impact severely on government income from road users.

Roads of the future will require new materials and new planning techniques to accommodate a new mainstream intelligent kind of vehicle, and will also require major changes to existing infrastructure at a massive cost to taxpayers.

With driverless cars, who is at fault if an accident occurs? Can intelligent driverless cars be stolen without the car reporting it to the authorities? These questions could have profound implications for the short-term insurance industry, whose main source of income is car insurance premiums.

As we can see from this overview and the examples in it, industry changes do not occur in isolation – they could have profound impacts on customers, incumbent players in the industry, regulators and supporting industries.

Overview

This chapter focuses on an analysis of the industry environment, in which the two most important forces are competitors and customers. The chapter begins by examining what an industry is and how the various players in it

interact and compete. It then focuses on the analysis of competitors and customers as a means of understanding how their perceptions, actions and reactions could influence and shape strategies.

6.1 Introduction

The previous chapter examined the impact of the macroenvironment on an organisation. This chapter focuses on the environment in which the organisation is a direct participant – the industry environment. An **industry** can be described as a ‘group of firms producing products that are essentially the same.’² In the industry environment, the organisation deploys a competitive or business strategy that strives to attain a sustainable competitive advantage. It should be noted that an industry is not the same as a **market**, which can be described as a group of customers for a group of products and services that satisfy the same need. One industry can accordingly serve many different markets.

As we can see from our Opening case study, there are many influences in the immediate environment that affect an organisation’s potential competitive position. Thus the organisation’s interaction with competitors, customers and other industry role players may have a profound impact on its relative competitive advantage and profitability, and that of other industry players.

Understanding the industry and industry dynamics can assist an organisation to select the best strategies to deal with industry conditions (the outside-in perspective – see [Chapter 1, section 1.5.2](#)). In examining the industry environment, this chapter will focus on two broad areas of analysis:

- Industry analysis necessitates defining the industry, understanding **industry key success factors**, the effects of industry evolution, industry structure, and competitive and cooperative dynamics.
- Intra-industry analysis focuses on the analysis of competitors and customers in the industry to identify opportunities for creating or protecting competitive advantage.

6.2 Industry analysis

The aim of industry analysis is to understand the reasons for variations in profitability over time and, if possible, capitalise on them. In short, the purpose of industry analysis is to identify opportunities and threats in the industry environment. The process of analysing the industry environment comprises three broad steps. First, the industry must be defined; second, the key success factors of the industry should be identified; and finally, the relationships that shape the industry and how they influence profitability should be examined.

6.2.1 Defining the industry

A question often asked by organisations when thinking about strategy is: ‘What business are we in?’ This question suggests that the industry should be defined before industry analysis can take place, and that it is important to be able to define the relevant players in the industry. This is generally much more difficult than it seems as it involves a strong element of managerial judgement.

First, it is always difficult to decide whether to define an industry broadly or narrowly. Defining it too broadly has the disadvantage of diluting focus and increasing complexity, while defining it too narrowly means that important opportunities or threats may be missed.

Second, industry convergence can change or blur the boundaries of an industry. Convergence occurs when two or more previously separate industries begin to behave as though they are linked. For example, in our Opening case study we can see how the automotive and information and communication technologies (ICT) industries are merging through the production of self-driving or driverless cars.

When considering the boundaries of an industry, three dimensions of scope can be used, namely horizontal, vertical and geographic scope.³ These dimensions are briefly defined and illustrated below using the automotive industry as an example:

- *Horizontal scope* defines the range of products and markets addressed. For example, we could argue that small economy cars do not compete with expensive sports cars; therefore, a broad definition such as the 'automotive industry' is not necessarily useful in analysis.
- *Vertical scope* defines the range of supply chain activities the analysis will consider. For example, which elements of the automotive industry value chain does the analysis consider – parts manufacturing, car manufacturers, vehicle assembly, retailing or after-sales service?
- *Geographic scope* defines the range of geographic analysis. For example, will the analysis consider a provincial, national, regional or global scope? For a local car dealership, considering the entire global market may not be useful.

It is important to note that the definition of industry cannot be divorced from an analysis of the industry structure. Understanding substitutability (see [section 6.2.3.1](#)) and complementarities (see [section 6.2.3.2](#)) can provide important clues and guidelines for drawing industry boundaries.⁴ For example, understanding that small economy cars will not substitute for sports cars is an important guideline in defining the industry. The definition of industry is not a once-off process, but an iterative one that constantly needs to be updated and revisited as industries change.

Once the industry has been defined, the next factor to consider in industry analysis is the identification of industry key success factors.

6.2.2 Industry key success factors

To understand the external sources of competitive advantage fully, Robert Grant suggested that organisations need to understand their industry's **key success factors**.⁵ These are factors in the organisation's external environment that determine its ability to survive and prosper. Note that key success factors apply to all organisations in an industry. They depend on the 'three Cs' as defined by Kenichi Ohmae:⁶

- *Customers*: What do customers want?
- *Competition*: How can the organisation compete successfully?
- *Corporation*: What unique resources does the organisation possess?

The list of key success factors should not be a long list, but should generally be those three to five factors that are critical to the success of the organisation. The Case example *Key success factors* below provides some indication of the role of key success factors in strategic choice.

CASE EXAMPLE: Key success factors

- For low-cost airlines, such as [kulula.com](#) and Mango, delivering their service at the lowest possible cost is a key measure. To achieve this, asset utilisation is one of their key success factors. This in turn suggests that the choice of low-maintenance aircraft, the availability of low-cost alternative airports (e.g. Lanseria) and quick flight turnaround times are ways of maximising asset utilisation and enabling reduced fares for passengers.
- For pharmaceutical companies producing ethical (patented) drugs, the rate of approval of new drugs by the relevant authorities is critical and could be a key success factor. To maximise the approval rate, the intensity and scope of research and development activities, and finding multiple uses for the same active compounds are important.⁷

Despite research finding organisations rating highest on key success factors outperforming their rivals, the concept is criticised by Pankaj Ghemawat and others due to:⁸

- *Identification*: Many factors in an industry could potentially be key success factors, making it difficult to identify the ones to focus on.
- *Concreteness*: It is not always clear how key success factors interact with one another and how they affect the organisation's performance.
- *Comparative advantage*: Competitive advantage rests on differential performance. If all organisations in an industry perform well on the key success factors, it does not offer any basis for competitive advantage, and may accordingly be dangerous for organisations to base their strategy on.
- *Necessity*: Since industry dynamics and change may offer better explanations for the dynamic aspects of strategy and offer a better basis for competitive advantage than industry key success factors, the necessity of the concept is .
- *Generality*: There is no guarantee that key success factors can be profitably exploited by organisations, because the benefits from exploiting them must be higher than the cost of exploiting them. It is not always clear to what extent these are undervalued and offers an opportunity for generating profit.

However, we use the idea of key success factors here in much the same way as Grant suggested – as a way to understand the industry as a prerequisite to effective business strategy. As customer requirements and competition differ from industry to industry, so do key success factors. We now explore key success factors in three different industry settings namely mature and declining, technology-intensive and not-for-profit industries.

6.2.2.1 Industry key success factors in mature and declining industries

Mature industries are characterised by low growth in demand and will eventually decline. This industry growth stage limits opportunities for differentiation factors as a source of competitive advantage and shifts them to cost-based factors. Grant identified the following opportunities for competitive advantage in mature industries:⁹

- *Cost advantage*: This is established through economies of scale, low-cost inputs or low overheads. However, **cost leadership** may be difficult to sustain as it refers to a strategy that allows an organisation to achieve superior profits by producing its products or services at a significantly lower cost than that of competitors.
- *Profitable market segments*: Selecting profitable **market segments** may increase profitability in unattractive markets and may extend to targeting profitable customers.
- *Differentiation*: While opportunities in mature markets are few, this does offer an alternative to the pressure of constant price competition. In mature industries, complementary services may provide a basis for differentiation. For example, the automotive industry has much competition around financing, insurance and maintenance plans.
- *Strategic innovation*: While mature markets offer few opportunities for product innovation, they do offer opportunities for strategic innovation. Embracing new markets and adding products and services that offer new but related functions present opportunities for strategic innovation. For example, when cellular telephony started maturing in South Africa, a leading operator Vodacom announced its intention to become a 'total communications provider', and increased its focus on data services.

In declining industries, there is generally excess production capacity, few competitors, lack of product innovation, ageing products and human resources, and aggressive price competition.¹⁰ Under these conditions, key success factors may relate to the extent to which organisations are able to plan and execute successful **end-game strategies** (see [Figure 6.1](#)). This refers to one that allows an organisation to maximise its returns at the end of an industry life cycle. In selecting end-game strategies, certain factors play a role:

- The relative competitive position of the organisation (whether it is strong or weak)
- The conditions of decline, which are favourable when the decline phase still offers opportunities for profitability (e.g. where there are still strong pockets of demand) and unfavourable when there are few remaining opportunities to be profitable.

End-game key success factors may include the following:

- **Leadership**: This relates to the organisation's ability to use competitive strengths to gain dominance in remaining pockets of demand where industry conditions for decline are favourable – in other words, retaining attractive segments of the market. This provides a strong position for a successful harvest strategy in future. As the world moves towards free online content, Encyclopaedia Britannica has business units focused on serving schools, defence forces and homeland security units, all of which have compelling reasons not to depend on free content.¹¹
- **Niche**: With this strategy, the organisation uses competitive strengths to gain a strong position in a small segment where industry conditions for decline are unfavourable, but who are not price sensitive (demand is inelastic) and demand is relative stable. Louis Vuitton, for example, is a producer of very expensive luxury handbags and travel cases that targets a small number of customers who are not price sensitive.
- **Harvest**: Under similar conditions where the market is declining, maximising cash flow from existing assets while limiting investment and reducing costs is known as harvesting an asset, and may be a key success factor in declining industries. Fujifilm was a leading producer of film cameras, but when digital cameras hastened the decline of that industry, Fujifilm channelled most of their investment into digital imaging. Fujifilm still offers film cameras on a limited scale to niche markets (e.g. the film production industry), but it has focused much of its effort on developing digital imaging products such as digital cameras and optical devices.
- **Withdrawal**: Where the organisation does not have any competitive strengths in attractive niches, and conditions are unfavourable, withdrawal (such as a quick sale of the business or liquidation) may prove to be the best option. 1time was a South African airline operating between 2004 and 2012. When it ran into trouble and could not obtain additional funding, the only option was to liquidate the business.

Figure 6.1 Strategies for declining industries¹²

	Competitive strengths in attractive niches	No competitive strengths in attractive niches
Favourable	Leadership or niche	Harvest or divest
Unfavourable	Harvest or niche	Withdrawal

Source: Adapted from Johnson, G., Scholes, K. & Whittington, R. 2005. *Exploring corporate strategy* 7th ed. Essex: Prentice Hall. 86

6.2.2.2 Industry key success factors in technology-intensive industries

In technology-intensive industries, the application of new technologies plays a key role in competitive advantage, therefore innovation is a key success factor in technology-intensive industries (see also [Chapter 9](#) for more on the role of innovation in strategy).

Innovators will not automatically appropriate the value of their innovation (i.e. claim the value created by the innovation) as competitors may imitate it with more success. For example, Research in Motion invented the

smartphone with the introduction of the BlackBerry in 1999. However, it was unable to sustain its success with the result that other players such as Apple and Samsung made far more money from their smartphones than Research in Motion ever did.

The conditions outlined below will determine whether innovators are able to appropriate the value of their innovation:¹³

- The protection of *intellectual property* is a key success factor in technology-intensive markets. This includes patents, copyright, trademarks and trade secrets such as recipes and industrial processes. Organisations are becoming increasingly aware of the value of intellectual property as a strategic asset that can be used to generate revenue, for example by licensing it.
- The impact of *complementary products and services* may determine whether the innovator will be able to appropriate the value from the innovation or whether the providers of complementary products will do so. Complementary products or services in this context refer to the products or services that the innovator requires to get the product or service successfully to market, such as manufacturing, financing, marketing and retailing. Should these services cost too much, this will erode the value appropriated by the innovator. On the other hand, 'building' the services from scratch may take too long and require a lot of capital investment. In the Case example below, we see how Apple cleverly juggled its investment in complementary services.
- Another key success factor relates to the extent to which technology can be copied; also known as codification. First, the extent to which knowledge contained in the technology is codifiable or tacit is important. Codifiable knowledge implies that the knowledge can be written down, for example a recipe. This type of knowledge, and therefore invention, is relatively easy to copy. Tacit knowledge, however, is built on the knowhow, experience, intuition and insight of employees, and is almost impossible to copy. In the second place, the complexity of the technology may offer protection against copying.
- The extent to which the innovator is able to establish a *lead time* over competitors and a temporary advantage as the basis for an industry leadership position can be key to its ability to appropriate the value from its innovation. Research in Motion, the company manufacturing BlackBerry smartphone devices, launched the first smartphone in 2002, and thus had an early lead and source of temporary competitive advantage in this market with its innovative devices and services. Unfortunately, service problems and RIM's failure to follow on the BlackBerry with other innovations led to its being blindsided by the launch of the iPhone in 2007, resulting in a sharp decline in its share of the worldwide smartphone market.¹⁵

CASE EXAMPLE: Apple's complementary services¹⁴

Apple's profitability is the envy of the industry. For example, in the fourth quarter of 2017, it captured 87% of smartphone profits while only selling 18% of the units in that industry. While there are many possible reasons for this success, Apple has been very astute with its use of complementary services. Let us look at three such relationships:

- Apple does not do the manufacturing of its products. Like many other electronics providers, these are manufactured in China. One of the reasons is that manufacturing requires a different skillset than Apple possesses, and to set up a manufacturing capability will require massive capital investment, require a long learning curve and may cause a loss in focus on its core business.
- Apple owns its own operating software, while most of its competition comes from the open source Android platform. While open source is cheaper in some ways and offers inter-operability between many different brands of devices, proprietary software offers higher levels of security and customisation.
- Apple has increased its investment in its own retail stores sharply over the past few years, growing from 273 stores in September 2009 to over 500 in 2018. Owning retail stores means that Apple cuts out independent retailers that take a share of the profit and put downward pressure on prices and margins. Because of its

focus on the creation of a customer experience, Apple has shown double-digit growth in its retail sales at a time when other retailers are struggling.

Standards have always played a key role in technology-intensive industries. In many instances, governments or other regulatory bodies set technology standards. Winning a 'standards war' is generally a big step towards competitive advantage, as Microsoft with its Windows operating system has demonstrated. From our Opening case example, we can see that there will have to be standards for dynamic wireless charging so that it can be used for all vehicles. The following are guidelines for winning the battle for industry standards:¹⁶

- Assemble allies before you go to war. Enlisting the help of suppliers, customers, complementors, and even competitors is critical for building the competencies necessary to develop a standard.
- Pre-empting the market – even seeing an industry where none currently exists – can be beneficial when competing for standards.
- Manage expectations and convince allies that you will emerge victorious. In many instances, this becomes a self-fulfilling prophecy.
- Perseverance may be a key factor in establishing standards – in other words, simply refusing to give up.

6.2.2.3 Industry key success factors in not-for-profit settings

Not-for-profit organisations, whether publicly or privately funded, generally exist for the greater good of society. They provide certain collective goods or services (such as a police service or museums) that profit-making organisations cannot or will not provide.¹⁷ In return they receive certain benefits from society, such as exemption from certain categories of taxes. Achieving strategic advantage often requires not-for profit organisations to behave more like commercial organisations. There are several aspects that could create strategic advantage for not-for-profit organisations¹⁸:

- The organisation must determine whether customers would be willing to pay for goods or services closely related to the organisation's core activities. Museums, for example, usually sell memorabilia in a museum shop and universities sell branded clothing and other goods.
- Not-for-profit organisations may benefit from professional management talent that would normally be required to manage a revenue-generating business. This factor should engender a more business-like attitude to obtaining funds and to foster innovation in combination with practical business considerations.
- Trustees and Boards of not-for-profit organisations could contain more business-minded trustees or board members that would support more 'commercial' ventures.
- Any business requires capital to grow, and this may be obtained from partnerships with business organisations. For example, Public Private Partnerships (such as toll roads and the Gautrain) are becoming popular as a means of developing infrastructure. In such partnerships, government or other not-for-profit organisations will provide the right to develop infrastructure to a private business, who then obtains the right (typically in the form of a long-term contract) to operate the venture for profit for a certain time.
- Merging with similar organisations may provide struggling organisation a way of reducing costs and becoming more efficient. For example, there are many small NGOs that provide feeding schemes for the needy. Merging and creating a larger organisation may mean that they can increase their negotiating power and scope as a means of reducing costs and creating more income, for example by obtaining donations from supermarkets.
- Strategic alliances provide a means of temporary cooperation to enhance capacity in order to better serve clients and generate resources. Where disaster strikes on a large scale, different charities such as the Red Cross/Red Crescent and Oxfam often join forces to provide relief. Alliances between not-for-profit and business

organisations are the next logical step. Discovery Vitality, for example, often partners with charitable organisations to offer the option of donating to a charity as a reward to Vitality members.

A key aspect of strategy in not-for-profit organisations is the relative importance of stakeholders. These organisations have many stakeholders, often with different expectations. Clients, trustees, donors, volunteers, the government and management are just some of the stakeholders typically involved in a not-for-profit organisation, all with a certain amount of influence and power. The challenge for these organisations is not to lose focus as so many different stakeholders with influence and power affecting them.

6.2.3 Relationships that shape the industry

In industry analysis, the focus is on understanding the impact of the industry's competitive forces on competitive advantage, and how it affects the relative profitability of industry players. Broadly speaking, there are two categories of relationships, namely those that reduce profits by negatively affecting cost and/or price, and those that enhance profits. This section explores Michael Porter's contribution to understanding industry structure, the notion of cooperative relationships and their impact on strategy, and the role of regulation in shaping industries.

6.2.3.1 Competition and industry structure

One of the most widely adopted contributions to the theoretical understanding of industry structure is the five forces framework for industry analysis developed by Michael Porter. Although Porter initially developed the framework as a means of assessing profit potential in an industry, it also provides a useful way of identifying sources of competition.¹⁹

The basic premise of the framework is that there are five forces interacting in any industry, namely:

- the rivalry between existing competitors
- the threat of **new entrants**
- the threat of **substitutes**
- the bargaining power of buyers
- the bargaining power of suppliers.

Before we examine the five forces framework, it is useful to keep the following caveats in mind:²⁰

- The five forces framework is useful at the level of strategic business units that focus on one industry (e.g. South African Airways), and not necessarily at the level of a diverse organisation or multi-business corporation, such as the Bidvest Group, that spans several industries.
- It is important to understand the connections between the five forces and the macroenvironment. For example, technology changes (such as the increasing capabilities of cellular phones and mobile data communication) can fundamentally affect traditional 'rules of competition' in an industry.
- The five forces are interrelated rather than independent, and pressure on one force may trigger changes or shifts in other sources of competition. For example, suppliers that are blocked or undercut may try to find ways of selling directly to end-users.
- Some competitive behaviour may be concerned with disrupting the forces of competition, and not with simply accommodating them. For example, in fast-moving environments, competitors may be more concerned with disrupting competitive forces to achieve a series of short-lived competitive advantages than with building and sustaining long-term competitive advantage.

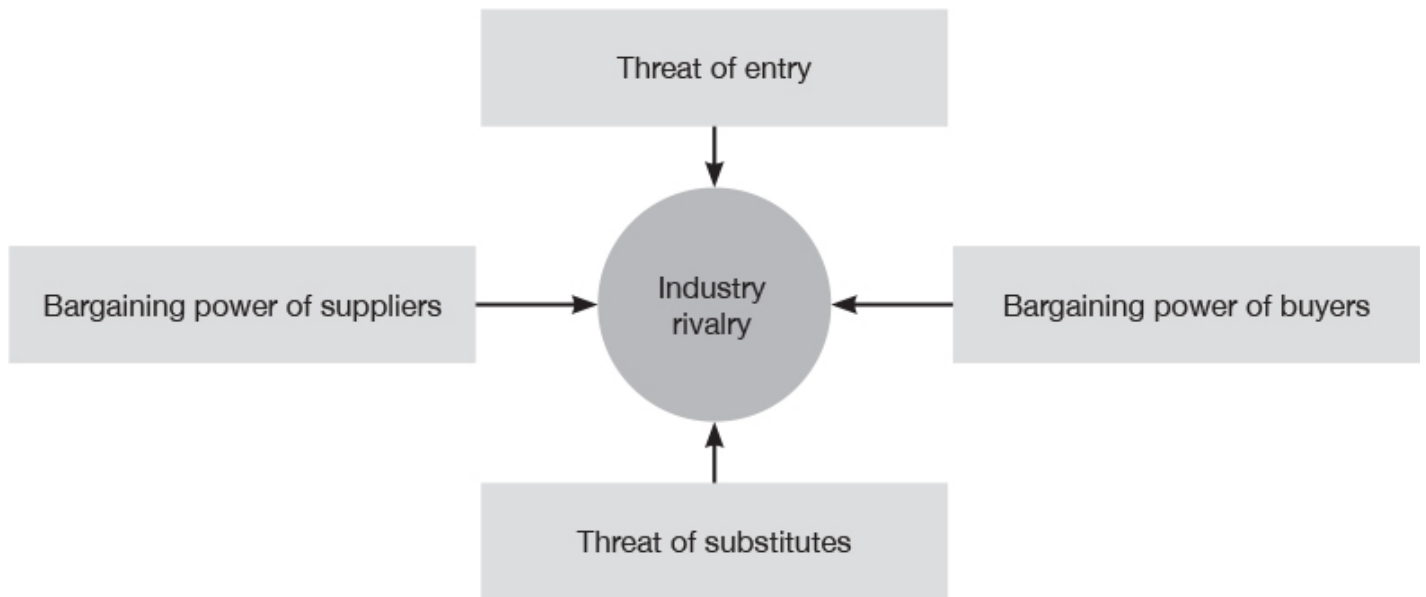
The relationships between these five forces are shown in [Figure 6.2](#). The relative power of the forces describes the structural influences on industry profitability. Added value in an industry is created by the difference between the highest price that customers are willing to pay for a product or service (willingness to pay), and the lowest price that

suppliers are willing to accept for a product or service (supplier opportunity cost). Each force affects the added value in the industry.

There are also some basic industry structures that influence competition and rivalry in different ways. Three basic forms of competition are discussed below:²¹

- *Monopolies*: The opposite of competition is a monopoly, where only one organisation serves the market. In many countries, electricity generation is a monopolistic industry, for example Eskom in South Africa (at the time of writing). Monopolists can control production, and charge what suppliers and customers will let them. They are generally limited only by substitutes and regulation. In the case of electricity generation, households could use alternatives (substitutes) such as generators, solar panels, gas or even wood as a means of generating energy for household use. In addition, Eskom has consistently asked for price increases far higher than inflation, but the regulatory authorities have often put downward pressure on such requests.
- *Perfect competition*: The most intense form of competition is known as perfect competition. In conditions of perfect competition, there are many competitors producing similar products or services, with similar market positions. Entry into the industry is relatively easy, and there is no effective way of protecting innovations. The result is that profit margins are low, and as production volumes (or numbers of competitors) increase, prices may be driven even lower. The only way to create competitive advantage, and superior profits, is to create and protect market positions that are different from the competition, and even then this is likely to last only as long as the organisation is able to protect its position.
- *Oligopolies*: In an oligopoly, competition is limited to a few large players that dominate the market, even though there may be many other organisations competing. In most countries, the banking industry is an example of oligopolistic competition, with a few large banks dominating the market. Competition is therefore concentrated. Dominant competitors are aware that their actions may have an impact on market prices and profits, and may be reluctant to take drastic action. In the worst cases, such competitors may even resort to illegal behaviour such as collusion or cartels to maintain stability.
- *Hypercompetition*:²³ Hypercompetitive industries are characterised by competitive actions that are so bold, aggressive and frequent that this creates a constant sense of disequilibrium. Oligopolistic industries often break out in hypercompetition. For example, in the mobile smart-device market, dominated by Apple, Samsung and Huawei, new smartphones, tablets and apps are constantly being launched. In 2018, for instance, Apple launched the iPhone XS and the iPhone XS Max.

Figure 6.2 Porter's five forces framework for industry analysis²²



In these examples, we have seen some of the effects of competition (or lack thereof) on profitability in an industry. When conducting an analysis of the industry, the first step should be to define the industry and to determine the viewpoint of the analysis – from whose perspective is the analysis being conducted? After doing that, each competitive force can be analysed using the factors driving competition, for example by rating them as high, medium or low. The last step is then to conclude on the biggest competitive threats where they originate from, and what the organisation can do about them. Each of the five forces will now be discussed in more depth (also see [Figure 6.3](#)).

The degree of rivalry between existing competitors

Rivalry among existing competitors in the market is the most obvious and immediate source of competition. Competitive rivals are organisations with similar products and services aimed at the same customer group.²⁴ There are several factors that influence the level of competitive rivalry.²⁵

- *Number and size of competitors:* The more competitors there are and the more equal they are in size and power, the more intense rivalry will be. For example, in the electronics retail industry there are several large competitors such as HiFi Corporation, Dion Wired, Hirsch's and Makro. This rivalry leads to intense price competition and discounting.
- *Rate of industry growth:* When industry growth is slow, competition may be more intense as competitors battle for market share. Therefore, as industries mature one would usually expect competitive intensity to increase. For example, as the South African cellular industry matures, there is more competition for high-value customers such as high-income individuals and businesses.
- *Differentiation and switching costs:* If a product or service lacks differentiation or customer switching costs are low, customers are not locked in, and this may lead to more intense competition. This explains why competition in commodity markets is often intense. Short-term insurance is an example of an industry where most competitive products are similar and switching costs are relatively low (one phone call is often all that is required), leading to a high level of competition. Aggregate service providers like Hippo (www.hippo.co.za) provide shoppers for short-term insurance with the necessary information from many short-term insurance providers so that they can easily compare insurance quotes online. On the other hand, where certain competitors have managed to create high levels of differentiation customers may not be willing to switch because of their commitment to the brand or organisation, or they may be locked into contracts (e.g. in the cellular telephony industry).

- *Fixed costs or perishable products:* Where fixed costs are high or products are perishable, there may be pressure on competitors to cut costs. For example, when there is excess production of perishable products such as milk or fruit, prices will drop to sell higher volumes.
- *Expansion:* Where production capacity can be increased only in large chunks, capacity expansion may lead to temporary excess capacity and price cutting. For example, automotive producers can only add capacity in relatively large chunks by installing a new production line or factory. When such capacity additions are made, producers could use lower prices as a means of generating higher volumes, in this manner using the capacity which has been added.
- *High exit barriers:* Where exit barriers, such as specialised assets, are high, competitors may try to compete for as long as possible for low or even negative returns. Given the investment that automotive producers (and the government) have made in the industry in South Africa, producers would rather sell at a discount and lose money for a time than close down and exit the industry too soon.
- *Diverse strategies:* Where rivals are diverse in strategies and origins, 'personality clashes' may occur as they have different ideas about how to compete and how the industry works. For example, in the short-term insurance industry, OUTsurance, MiWay and other direct short-term insurers provide a service that eliminates insurance brokers, whereas other organisations such as Mutual & Federal traditionally use brokers as their sales and service points and believe that is in their best interest to continue doing so.

The threat of new entrants

Whenever an industry becomes profitable, there are incentives for other competitors to enter the market. The success of their entry is dependent on the existing barriers to entry in an industry, of which there are several.²⁶

- *Economies of scale:* The economies of scale required to be successful can provide a barrier to entry in some industries, such as manufacturing capacity in the automotive industry.
- *Capital cost of entry:* The capital cost of entry into an industry can provide a barrier to entry. This is especially true of capital-intensive industries such as gold mining or electricity supply.
- *Control of distribution channels:* Where existing competitors have control over distribution channels, whether through direct ownership or simply by virtue of customer or supplier loyalty, this can provide a barrier to entry.
- *Good relationships:* Where existing competitors have good relationships with customers and suppliers, or where customers and suppliers are locked into relationships with competitors, for example through contracts, new entrants may find it difficult to break into the industry.
- *Time:* Because of the experience curve, existing competitors that have been in the industry for longer may have cost or other advantages (such as customer or supplier loyalty) because of their time advantage.
- *Retaliation:* Expected retaliation by existing competitors can deter new entrants. Unless ways are found to compete so as not to elicit retaliation, entry into certain industries may not be worthwhile.
- *Legal restraints:* These can provide a whole range of barriers or deterrents to entry. Patents, copyright or even outright regulation restricting new entrants (such as in the electricity generation industry) are all examples of legislation or government action and its impact on new entrants.
- *Differentiation:* Where differentiation exists – in other words, where customers perceive that a product, service or even a product package, offers better value than the competition – entering that industry may be difficult unless ways are found to imitate the offering or to reduce customer loyalty. However, this may require heavy spending on advertising and promotions.

The threat of substitutes

Substitutes are those products or services that an industry's customers can turn to, seeing as these products or services satisfy the same basic need. This normally takes the form of new technologies or business models. The effect of substitutes is that they place a ceiling on the prices that industry competitors can charge, and therefore limit the

industry's profit potential.²⁷ In certain cases, substitute products or services can lure customers away from an industry despite higher prices. For example, digital video disc (DVD) technology, which displaced video cassette recorder (VCR) technology worldwide, was in turn displaced by more expensive Blu-ray disc technology.

There are three types of substitution.²⁸

- *Product-for-product substitution* occurs when customers substitute existing products and services with new and improved ones, for example Blu-ray replacing DVDs as mentioned above. This may occur because of industry convergence, as discussed in [section 6.2.1](#), where, for example, electric cars with advanced ICT capabilities, such as self-driving capabilities, are substitutes for traditional or hybrid cars. Substitution may also occur because of complementary relationships, such as the one between Windows and Intel, where products are constantly updated, and users have access to the latest versions.
- *Substitution of need* occurs when a new product or service renders an existing one redundant by satisfying the same need. The substitution of digital cameras for film cameras is an example of this category.
- *Generic substitution* occurs when products or services compete for disposable income. For example, when consumers have less disposable income during a recession, they may trade down or may stop buying certain categories of products altogether.

The bargaining power of buyers

The relative **bargaining power** of buyers (customers) can have an impact on the prices that can be charged by competitors in an industry (willingness to pay). Where buyers are powerful, they will negatively affect the ability of competitors to charge high prices or to raise them. However, less powerful buyers mean that competitors have more freedom to charge high prices. The following are determinants of the bargaining power of buyers.²⁹

- *Buyer concentration*: Where there is a concentration of buyers – in other words, a few large and powerful customers or customer groups, or buyers that purchase large volumes – this may increase their bargaining power, especially where there are a large number of suppliers. For example, large retail groups such as the Shoprite Group, Pick n Pay, and Woolworths have a lot of bargaining power to exert downward pressure on the prices of individual food producers (see Strategy in action *The buying power of large southern African supermarket chains is keeping small suppliers out* on page 193).
- *Switching costs*: The bargaining power of buyers is high when the cost of switching suppliers is low. This may include situations where the product or service is undifferentiated and generic, i.e. a commodity.
- *Backward vertical integration*: If there is a threat of backward vertical integration – in other words, the threat of a buyer acquiring the supplier or setting up their own sources of supply – then this will increase the bargaining power of buyers.
- *Ratio of purchase price to total cost*: Buyers, who themselves are often producers or providers of services, will generally be less price sensitive, and as a result less inclined to shop around, when the purchase price of a product or service is a small fraction of their total production cost, and is not important to the quality of their production. Buyers who are highly profitable and interested in quality rather than price are also less price sensitive. For example, an organisation that produces furniture may be less sensitive to the price of stationery, as it will only represent a small portion of their total production cost and stationery also does not affect the quality of the furniture they produce.
- *Information*: The more information buyers have about suppliers' pricing structures and input costs, the more powerful they will be.

The bargaining power of suppliers

The relative bargaining power of suppliers determines the supplier opportunity cost. This affects input prices, and therefore the profitability, of competitors, as we can see from the Strategy in action case: *The buying power of large*

southern African supermarket chains is keeping small suppliers out (page 193). Similar forces to those determining buyer power determine the bargaining power of suppliers:³⁰

- *Supplier concentration*: The larger and more concentrated suppliers are, the more powerful they will be. Again, this power will be enhanced if there are many buyers. This is the case in the banking industry where there are relatively few banks to service many customers. (Also see the Case example *AB InBev* below.)
- *Switching costs*: The bargaining power of suppliers is high where the buyers' cost of switching suppliers is high. This may include situations where products or services are unique or so differentiated that it would be difficult to develop alternative sources of supply.
- *Forward vertical integration*: The threat of forward vertical integration could increase supplier bargaining power. This threat exists when suppliers are not making sufficient profit margins, and could acquire their own channels or bypass existing intermediaries to sell directly to end-customers. For example, Apple and many other electronics and appliance manufacturers (such as LG and Samsung) have invested heavily in their own retail spaces, which increases their bargaining power with other retailers.
- *Lack of substitutes*: If there are no substitutes available, this may increase supplier bargaining power.
- *Dependence on a single industry*: Sometimes the fortunes of suppliers may be closely tied to a single industry or even a single customer (such as a coalmine being dependent on a single power station). For example, the manufacturers of car seats are dependent on the automotive industry. In this case, this will reduce suppliers' bargaining power.

CASE EXAMPLE: AB InBev

In 2008, the Belgium-based brewer InBev acquired the American brewer, Anheuser-Busch, to become Anheuser-Busch InBev (AB InBev). In 2016, AB InBev acquired SABMiller in a deal worth \$103 billion (R1.4 trillion), sealing the union of the world's two biggest beer makers. The SABMiller name was dropped, but SAB still exists as an AB InBev subsidiary.³¹ As a dominant player in the South African beer market with key brands such as Castle and Black Label, and a distributor for Coca-Cola through its soft-drink division Amalgamated Beverage Industries (ABI), AB InBev subsidiary SAB exerts a strong influence over the retailers of liquor and soft drinks. The manufacturer thus has much influence over the wholesale as well as the retail price of beer and soft drinks, and in-store merchandising strategies. This is a typical example of a situation where reduced buyer power means more profit to a supplier.

Despite the widespread acceptance and usefulness of the five forces framework for industry analysis, it has not gone without criticism, and it has several limitations:³²

- It is a *static* framework, viewing industries as stable and shaped by external forces. In many industries today, the reality is that industry structure and boundaries are constantly changing.
- It assumes that organisations are essentially *selfish* and will always put their own interests first. This is not true of not-for-profit and public-sector organisations. Also, with the increasing focus on sustainability, this perspective may be somewhat outdated.
- While the framework approaches the five forces as *equal*, this may not be true, especially for customers. There are many observers who suggest that customers are the most important component to any aspect of strategy.
- Porter's view is essentially one of the industry environment as a *threat*, and it focuses on those relationships that reduce profits. It therefore largely ignores profit-enhancing relationships such as cooperation.
- It also mostly ignores the *human elements* of strategy such as the role of management skills in strategy.
- The framework seems to be predisposed towards a *top-down* or prescriptive approach to strategy – identifying opportunities and threats in the environment and formulating a response to them. There is little room for emergent strategies.

- There has never been consensus among researchers on the effect of the industry on *organisational performance*.
- Economists have questioned its *theoretical foundation*. It is based on the structure-conduct-performance approach to industrial organisations, which has largely been displaced by game theory.

Up to this point we have focused mostly on those relationships that reduce profits. The value net, however, emphasises complementary relationships that enhance profitability.

6.2.3.2 Complementary relationships – the value net

While the five forces framework focuses on substitutes as a competitive relationship, economic theory also identifies complements as a relationship.³³ This relationship is not addressed by the five forces framework. However, Brandenburger and Nalebuff emphasised the importance of complementary relationships in their value net concept. The value net concept examined similar constructs to Porter's five forces framework, but also focused on value-enhancing (complementary) rather than value-destroying relationships (such as bargaining power).³⁴ Complementary relationships are profit-enhancing because they increase the maximum price that customers are willing to pay for a product or service. Many strategy authors regard complementary forces as a useful extension of the five forces framework, as Figure 6.3 shows.³⁵

A **complementor** can be defined as follows: 'A player is a complementor if a customer values your product more when they have the other player's products than when they have your product alone.' The value net also considers other forces similar to the five forces framework, namely competition, customers and suppliers. In the context of the value net, competitors are the opposites of complementors, and are defined as follows: 'A player is a competitor if customers value your product less when they have the other player's product than when they have your product alone.'³⁶ For example, as we can see in the Case example *Complementary relationships in the smart device industry*, the existence of apps makes smartphones more valuable to their users, and increases their willingness to buy them and to pay higher prices for them. For that reason, we can say that smartphone manufacturers and app developers have a complementary relationship.

Using this definition, it is important to note that complementors are not merely suppliers, partners or allies. There is a specific relationship that enhances value and profitability for both parties. However, while relationships with complementors can enhance profitability, they also need to be managed with regard to the distribution of added value among an organisation and its complementors. Some of the forces determining this are discussed below:³⁷

- *Complementor concentration*: The more concentrated complementors are, the more powerful they will be. Organisations will therefore often deliberately establish relationships with many different complementors to reduce this power. Nintendo, for example, makes use of many different developers of games for its gaming consoles, meaning that no single producer of Nintendo games will become more powerful than the producer of the console.
- *Switching costs*: Relative switching costs may determine who controls added value. For example, when buying short-term insurance with banking products such as vehicle financing, it is easier and cheaper to switch insurance companies than to switch banks. This makes the position of banks much stronger in capturing added value.
- *Unbundling complementary products*: A similar principle comes into play when end-users can unbundle complementary products. For example, while apps (as a collective) add value to smart devices, the users of mobile smart devices can buy individual apps separately. The smartphone and the apps are therefore unbundled, which reduces the bargaining power of app developers. Conversely, DStv customers have to buy the full bouquet of content associated with their subscription package as it is 'bundled'.

- *Integration*: The threat of integration could increase complementors' bargaining power. This threat exists when complementors perceive that they are not receiving enough of the added value they create. A company like Samsung, for example, could develop its own apps for its smartphones and tablets if it felt that these complementors (the third-party developers of apps) were appropriating too much of the added value created by the relationship. This threat is usually asymmetric, giving bargaining power to the players that can most easily integrate – in the example above, Samsung is more likely to have the capabilities and resources to develop apps than an app developer will have to manufacture smartphones.
- *Dependence on a single industry*: In many cases, complementors are locked into a specific industry, which may reduce their bargaining power. For example, developers of games for games consoles such as Nintendo, PlayStation and Xbox are often tied to the gaming industry, and this may mean that they have less bargaining power than the manufacturers of the consoles.
- *Visibility*: Where complementors are much more visible than other players, they can come to 'control' the market and added value. For example, in subscription satellite television the content providers (such as Universal Studios, ESPN or Comedy Central) are much more visible than the signal carriers and service providers such as Multichoice. This poses a threat to the added value of the service providers.
- *Market growth*: The higher the market growth is, the less intense competition will be, and the less likely players will be to exert their bargaining power.

CASE EXAMPLE: Complementary relationships in the smart device industry

With the worldwide growth in the use of smartphones and tablets ('smart devices'), complementary relationships are proving to be critical to the industry. The developers of apps are an especially important complementor to smart devices, and literally millions of apps are available to their users. More apps mean more smartphones sold, and more smartphones mean more apps downloaded. In 2017, for example, it is estimated that 178 billion apps were downloaded worldwide, and there are 3.8 million apps available in the Google Play Store.³⁸ Most large banks now use apps for online banking, and one could therefore argue that apps are complementary to banking services as well.

The next section explores the role of industry regulators in competition.

6.2.3.3 Industry regulation as a competitive force

While both the five forces and value net frameworks consider the role of the government and industry regulators implicitly rather than explicitly, the visibility and influence of this force in the South African context has increased dramatically over the last few years. These interventions normally have broader social objectives in mind, and there are indications that the role of the government or regulators in certain industries will increase rather than decrease.

This section serves to outline and clarify the role of the regulator as a competitive and cooperative force in the industry, as opposed to the many different ways in which it influences business directly and indirectly at the macroenvironmental level. The following are examples of how the regulator can play a direct role in an industry:³⁹

- *Maintaining barriers to entry*: In certain industries, the government and regulatory forces may maintain barriers to entry. The South African telecommunications, health and electricity supply industries are examples where industry regulators generally maintain barriers to entry through exclusive licensing and accreditation systems.
- *Price control*: To prevent monopolists and oligopolists from abusing market power, regulators may restrict their ability to raise their prices. In South Africa, the National Energy Regulator (NERSA) has regularly restricted Eskom to much lower price increases on the provision of electricity than they have requested.
- *Direct restrictions*: We have seen various occasions recently where the regulatory authorities and the government have chosen to place direct restrictions on practices that they regard as counter to the public interest. For

example, restrictions on advertising and promotions in the tobacco industry have been in place for some time now.

- *Scrutiny and control of mergers and acquisitions:* The government in some instances applies policies on mergers and acquisitions to protect competition. For example, in South Africa mergers and acquisitions are subject to scrutiny and approval by the Competition Board. In this way, government forces can sometimes directly influence industry structure and, as a result, the competitive forces in an industry.
- *Legislation:* Regulators can also cause industry disruption by introducing new legislation or regulations that change the industry landscape completely. For example, when the South African Electronic Communications Act was introduced in 2005, it opened up the market to much more competition and convergence. Although this liberalisation is still hampered by access to infrastructure and lack of regulation by the Independent Communications Authority of South Africa (ICASA), it has changed the way that industry participants think about competition.

From the above it is clear that the role of government can serve as both a profit-reducing force, for example when it exerts price control, or a profit-enhancing one, for example when it protects monopolists or oligopolists by maintaining or creating barriers to entry. The addition of the forces of complementors (see [section 6.2.3.2](#)) and industry regulation suggests that the five forces framework may be limited in its approach to industry structure. One approach for dealing with this is to consider an extended framework of industry competition.

6.2.3.4 An extended framework of industry competition

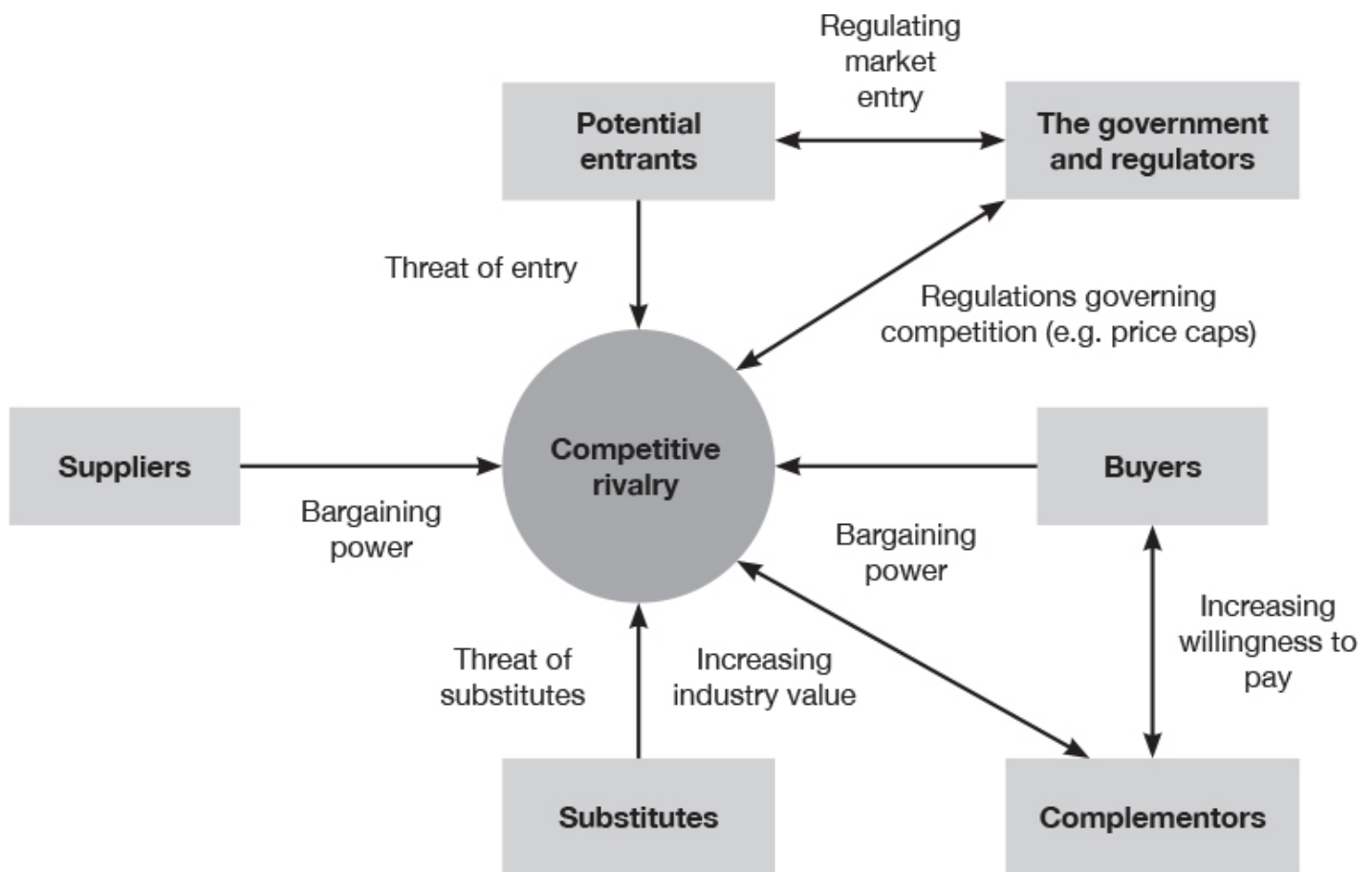
Some authors have suggested that the complementary force can simply be added to the five forces framework as an extension.⁴⁰ In the same way, Wheelen and Hunger 'extended' the five forces framework to include a force representing 'other stakeholders'.⁴¹ Given the specific influence of the government and industry regulators discussed above, the five forces framework has been modified to represent specifically the influence of government in regulating barriers to entry and competition, as illustrated in [Figure 6.3](#).

6.2.3.5 Cooperative relationships

Brandenburger and Nalebuff introduced and expanded on another key idea in the context of complementary relationships, namely the idea of 'co-opetition'. This is the notion that organisations may choose to cooperate in certain markets or circumstances, and compete in others. For example, telecommunications companies may cooperate to establish capital-intensive infrastructure such as undersea cables or fibre-optic networks, but will then compete in packaging and selling this infrastructure to end-users. Organisations such as Dell and Apple are also more likely to cooperate with the 'best in class' component manufacturers to develop and manufacture their products than to manufacture every component themselves. This is happening more and more with the growth in strategic alliances and cooperative relationships.

There are important limitations to cooperation between competitors as most governments do not allow collusion or cartels that control prices and promote unfair competition. In the light of increasing evidence of this happening in various industries, competition authorities generally investigate and prosecute companies found guilty of this type of behaviour (see the Case example *Collusion in the construction industry* on page 192).

Figure 6.3 An extended framework of industry competition⁴²



CASE EXAMPLE: Collusion in the construction industry⁴³

The rot appears to run deep and wide in South Africa's construction sector following recent damning allegations of decades-long collusion, yet prosecuting authorities may struggle with the implications of action against what appears to be a hard-hat mafia.

With the industry in crisis as a result of investigations into a long-running construction cartel and multibillion-rand fines on the table, many of the sector's top executives and managers could face jail terms.

All of this is a result of the Hawks, the National Prosecuting Authority (NPA) and South Africa's competition authorities' investigations into collusion in the sector. Twenty of the country's largest construction firms are under investigation by the competition authorities for running a cartel over a number of decades and roughly 20 more ancillary players will also face the music after being fingered by the larger players.

Some of the country's most prestigious construction projects, including Soccer City, the Greenpoint Stadium, the Coega Development Project, Nelson Mandela Bridge, the Gautrain, the Durban International Conference Centre, Nasrec Stadium, the Royal Bafokeng Stadium, Clearwater Shopping Mall and a number of large mining and manufacturing construction jobs have been listed in the affidavits as affected by the rampant collusion that has allegedly dominated the construction sector for at least the past two decades.

Organisations may also cooperate with buyers and suppliers, either by sharing information or by sharing resources or capabilities.⁴⁴ Sharing information, for example through joint planning or coordination of key activities, can lead to lower costs or higher value. For example, if retailers coordinate their logistics with their suppliers, this may lead to shorter delivery times and reduced inventories. In the same way, organisations may share resources or capabilities with suppliers or buyers to reduce costs or increase perceived value. For example, a supplier of auto-electrical

services may co-locate mechanical support staff with operators of large earth-moving equipment on a construction site to ensure reduced production downtime. Breakdowns can then be attended to much more quickly, which will contribute to better service and lower costs.

To protect their competitive advantage, organisations doing the sharing should ensure that the resources and capabilities they are transferring cannot easily be copied by competitors because of codification or standardisation. They must also ensure that some parts are unique and difficult to copy. For example, when Apple developed the iPod, suppliers of specialist components had to know the specifications of the components they were manufacturing, but no supplier (or even employee) had the full picture of what they were working on.⁴⁵

The five forces and value net frameworks both have the drawback that they are 'snapshots' of a moment in time rather than a changing picture of industry dynamics. In the next section, we address the evolutionary dynamics in industry.

STRATEGY IN ACTION: The buying power of large southern African supermarket chains is keeping small suppliers out⁴⁶



Supermarkets are a key route to market for many producers of food and household consumable products. The growth of supermarket chains in southern Africa presents important opportunities for such producers, as it potentially opens up much larger regional markets for them. Supermarkets can therefore be a strong catalyst to stimulate smaller producers such as food processors and fast-moving consumer goods manufacturers in southern Africa. But even the most efficient producers with competitively priced, high-quality products are unlikely to succeed if they cannot get their products to consumers, and this is where large supermarkets play a key role by providing shelf space to producers. However, onerous requirements and the exertion of buyer power by large supermarket chains can result in small- and medium-sized producers and entrepreneurs failing to enter and participate in the economy.

The formal South African supermarket industry (as opposed to smaller, informal street vendors) is concentrated, with only a handful of large chains holding more than 70% of the national market share. South African supermarket chains also have a strong and growing presence in southern Africa, although recent years have seen the emergence of other African and global chains too. Large supermarket chains therefore have considerable buyer power, and are often able to control pricing and trading terms with producers. This can include a range of fees and other obstacles to small producers:

- Producers have to pay listing fees (also referred to as slotting fees) to get on the purchasing lists of retailers. These fees can be prohibitive for small producers. Estimates of listing fees in South Africa range from US\$350 to \$3 500 per year for a single product line of a basic food item on the shelf. They can go as high as \$17 000 to \$20 000 for prime till positions for products such as sweets and lollipops for a limited time period. In Zimbabwe, listing fees can be up to \$2 500 per product line, with \$50 to \$100 for the introduction of additional new product lines by the same producer.
- Producers are also often required to offer supermarkets settlement discounts for paying them within the number of days stipulated in the trading terms. This varies depending on the producer.

Long payment periods put considerable pressure on producers' cash flow and working capital, which is problematic particularly for small producers. Local producers in Zambia raised this as a key reason for non-participation in supermarket value chains although it was a concern in all the countries studied.

- Supermarkets get discounts off the purchase price for indirect advertising of producers' products on their promotional material, such as pamphlets distributed in-store or in newspapers.
- Contributing towards promotions may be required. It can cost anything from \$2 500 to \$7 000 to promote a single product line as a contribution to the costs of the supermarket advertising through TV, newspapers and flyers.

- Paying to participate in different promotions held by supermarkets such as Easter and Christmas promotions may be required.
- A range of other fees also apply, varying by producer and according to industry. These include general discounts, fixed or variable rebates based on sales volumes, transport discounts and wastage allowances.

Cumulatively, the various fees can add up to at least 10–15% of the price of the product sold to supermarkets, placing considerable strain on producer margins. In addition, there are also other obstacles to smaller producers obtaining shelf space:

- It is critical for successful sales that products are displayed where shoppers can easily see them. Eye-level shelf space is often taken up by dominant producers, and smaller producers have to make do with less visible positions.
- Similarly, access to refrigeration space is important for producers of cold products such as soft drinks, ice creams and frozen food. However, in some instances dominant producers may impose exclusivity requirements on refrigeration space, meaning that a branded refrigerator may contain only products of that producer.
- Over and above legal requirements such as compliance with national standards, food safety, labelling and packaging requirements, producers also have to adhere to private standards imposed by supermarkets. These can include barcoding and specific packaging requirements as well as sustainability criteria and religious requirements (such as halal and kosher certifications). These can also include higher accreditation standards, which often involve ongoing audits at the producers' cost.

How can smaller and emerging producers be supported? Codes of conduct between producers and supermarkets can be a useful way to control the exertion of buyer power. In the UK, for example, the Groceries Supply Code of Practice was set up specifically to oversee the relationship between supermarkets and their producers following an inquiry by the former Office of Fair Trading.

Supermarkets can also play an active role in building the capabilities of producers. Almost all supermarkets in South Africa have some form of voluntary producer development programme in place.

Some positive outcomes for black entrepreneurs in food processing have been realised. One beneficiary, Lethabo Milling, a new entrant producing maize meal, received around \$110 000 towards refurbishing its plant, and was able to secure a loan from a commercial bank on the back of a guaranteed route to market through supplying Massmart stores in South Africa. The company also received further support through training, waived listing fees and fast-tracked payments.

There is a need for more coordinated, sustainable and regionally focused interventions to increase the participation of producers in supermarket supply chains. These should aim to reduce barriers to entry by, for example, curbing supermarket buyer power and building capabilities of producers.

Questions

1. Conduct an industry analysis of the southern African food retailing market from the perspective of a small food producer using the extended framework of industry competition. What industry forces have the highest current and future impact on small producers?
2. Identify and explain what strategic alternatives other than large retailers are available to small food producers to sell their produce?

6.2.4 Industry evolution: Competition over time

There are various frameworks dealing with the concept of life cycles in business, or so-called **S-curve** analysis. For the purpose of this discussion, the industry and technology life cycles are particularly important.

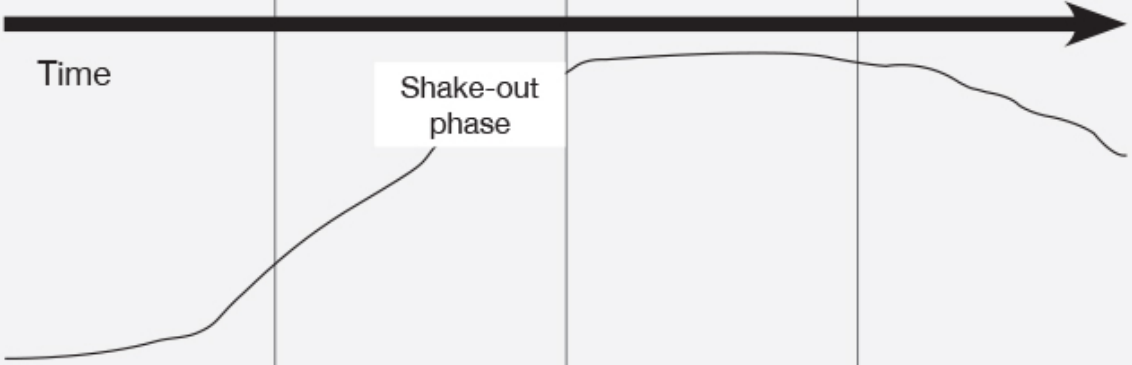
The industry or product life cycle examines how the passage of time influences revenues and competition with regard to a particular industry or product. The **industry life cycle** expands on the notion that competitive rivalry is partly dependent on growth in the industry, and examines the levels of competition in the different phases of growth. This suggests that there may be different key success factors for different phases of industry growth that

could necessitate different strategies. In turn, organisations should be aware of where they are in the life cycle and be able to read the signs to develop effective strategies.

The industry life cycle, as illustrated in [Figure 6.4](#), suggests that any product or industry moves through several growth phases:⁴⁷

- *Development phase*: During the development phase, it is mostly early adopters that will buy the product on offer, and there will be few competitors. There may even be a temporary monopoly.
- *Growth phase*: During the growth phase, early followers will begin to purchase the product, and competitors will start entering the market to profit from market growth. Since growth is still high, competition is likely to centre on gaining market share rather than price. During this phase, competitors may try to gain some differentiation advantage.
- *Shake-out phase*: While growth rate starts declining, competitors are entering the market during this phase. However, the increasing rivalry and resulting lower profitability forces weaker competitors out of the market. This phase is the early phase of industry maturity. When the number of organisations entering the industry is lower than the number of firms exiting, this is known as the shake-out phase.⁴⁸
- *Maturity*: During maturity, growth peaks and may even start declining somewhat. Repeat sales are likely to fuel revenues. Since growth is low, the emphasis will be on retaining market share, and the focus is likely to shift to strategies focusing on efficiency and low-cost production. Growth is limited to late followers and laggards, and competition is likely to turn to price cutting to achieve volumes. There are probably many competitors. Weaker competitors, for example inefficient producers or those without a strong foothold in profitable market segments, may perish. During this phase, consolidation, for example through mergers or acquisitions, is also likely to occur.
- *Decline*: During the decline phase, usage will start to drop off. Some competitors may drop out, and competition may shift to retaining profitable niche markets.

Figure 6.4 The industry life cycle⁴⁹

Life cycle stage	Development	Growth	Maturity	Decline
Market growth				
Buyers	Early adopters	Early majority	Late majority (mass market)	Laggards
Customer strategy	Will experiment, and may need some explanation and education	Quality and reliability is important, and perhaps less price sensitive	Brand switching may occur, little new trial and adoption	Customers are more experienced and know the product well – may buy on price rather than innovation May migrate to substitutes
Business strategy	Will seek to gain market share by growing more quickly than competitors and building early mover advantage Cost is less important than quality (differentiation) Will create awareness and encourage trial	Counter competition by expenditure on marketing communication and new product features or improvements to increase market share rapidly	Cost reduction, few changes or improvements to products – strategy may shift to cost leadership Defend market share and retain profitable customers	Cost control, may look to exit or to establish strong positions in niche markets
Life cycle	Development	Growth	Maturity	Decline

stage				
Competitor strategy	Competition will focus on entering market as quickly as possible Temporary monopolies may emerge Early entrants will try to build up a strong lead, sometimes at the expense of profitability Early followers will try to imitate market leaders as quickly as possible	Late entrants may emerge, wanting to capitalise on growth and profits Competitors will try to innovate and build strong differentiated market positions Weaker competitors may exit as rivalry forces prices and margins down	Owing to imitation over time, there will be much less differentiation Gaining market share may be difficult and expensive Competition will focus on creating market perceptions (e.g. through advertising) Shake-out may see many smaller organisations exiting, and market share consolidating in a few large market leaders Mergers and acquisitions occur as competition consolidates	Price competition as marginal players exit the industry
Research and development (R&D) activities	High investment in R&D occurs	R&D will focus on finding product extensions or improvements ahead of the competition	Very low	None
Impact on profitability	High investments to gain early lead may result in	Profits will emerge despite downward	Profits will come under pressure, although market	Pressure on profits as prices fall, focus may

	losses	pressure on prices	leaders will still be profitable	shift to drastic cost reductions
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There are no specific time frames applicable to the life cycle. This may last a few months for some products and industries, or it may stretch over decades for other industries.

Knowledge diffusion plays a critical role in the industry life cycle. In the introductory phases of an industry, there may not be a dominant technology. Competition takes place between rival technologies. As diffusion of knowledge takes place, a dominant technology or standard may emerge. This may be enforced by government or regulators. For example, the GSM technology is, by regulation, the standard for cellular service in South Africa (see the Case example *Industry life cycle of the cellular industry* below). One particular technology may emerge from competitive rivalry as a de facto standard, for example Microsoft's Windows operating system.

CASE EXAMPLE: Industry life cycle of the cellular industry

The South African telecommunications industry provides a good example of the industry life cycle. In 1993, the telecommunications regulator licensed two operators to commence operations, namely Vodacom and MTN. In the early phase of development, operators focused on rolling out their networks to achieve national coverage. Prices were high and cellular phones were a luxury item with some status attached to them. As subscriber numbers grew exponentially, prices began to drop, and more and more packages were introduced. The focus shifted to the development of distribution channels.

In 2001 the regulator licensed a third operator – Cell C – and in 2009 Telkom SA entered the market with Telkom Mobile (and the 8ta brand) after selling its share in Vodacom. As the market for prepaid cellular service is now nearing maturity, prices are still declining (some prepaid packages are even sold below cost). Considerable consolidation has occurred, with Vodacom and MTN integrating forward and acquiring a number of service providers. With the introduction of number portability where customers can now retain their number no matter who their cellular operator is, operators have to focus even more on customer retention. In a further development, after 2005 (following new industry regulation) mobile operators have expanded horizontally, offering a much broader range of ICT services and solutions in a bid to secure more revenue from existing customers. Currently there is a very sharp focus on providing mobile and fixed data services. During the same time period, fixed-line telephony subscriptions declined as customers increasingly migrated to cellular telephony, while fixed broadband subscriptions grew sharply and then stabilised around 2014.

The idea of the industry life cycle is closely linked to the idea of a technology life cycle.⁵⁰ Many industries have been subject to the effects of new and disruptive technologies. Customer migration to new technologies is often a key reason why industries mature and decline. It therefore makes sense to monitor technological changes and how they may affect growth in the industry so as to develop a coherent strategy to deal with them. For example, the growth of the cellular industry has caused the number of fixed-line subscribers in South Africa to decline.

At the same time, new innovations can extend the life of a technology. Clayton Christensen described these technologies as sustaining and disruptive technologies.⁵¹ Sustaining technologies are consistent with the way in which incumbents understand their business, and enhance industry growth, for example the introduction of the prepaid cellular service. Disruptive technologies initially add no value to current customers. They are often ignored by incumbents until it is too late and the technology has improved, leading to a shift in customer preferences. This means that incumbents are often vulnerable to disruptive technologies. For example, when digital photography was introduced, it was dismissed by film camera manufacturers and even diehard film photographers as being too low in quality compared to film. However, as quality improved, photographers shifted to the new technology en masse, and some incumbents, like Kodak, were unable to make the switch successfully.

6.2.5 Conclusion

There are many different factors affecting an industry. The role of industry analysis is to examine the industry structure and forces with a view to providing an understanding of the opportunities existing in the broader industry environment to achieve or enhance competitive advantage. However, there are also many threats in the industry environment that an organisation must identify and deal with to achieve a competitive advantage. The next section focuses on the analysis of competitors and customers within the industry – in other words, intra-industry analysis.

6.3 Intra-industry analysis

While industry analysis provides generalisations that are useful for understanding the external sources of competitive advantage, much of the strategic decision-making of the organisation occurs in its interaction with individual or groups of competitors and customers within an industry. This is the focus of intra-industry analysis. In the next section on competitor analysis, we will focus on a framework for analysing competitors and strategic group mass, and provide an overview of other competitor analysis techniques.

6.3.1 Competitor analysis

Competitor analysis focuses on the interaction between the organisation and its most important rivals. Many organisations operate in situations where a small number of competitors – often even a single one – dominate their actions. For example, in the South African retail banking industry, ABSA, Standard Bank, Nedbank and First National Bank will tend to focus very much on competition with each other.⁵² Grant suggested that this observation also holds at the local level. For example, the local Shell service station's strategy will probably be dominated by the actions of the Engen service station down the road. Understanding competitors and the bases for strategic actions involves obtaining information about competitors, and understanding what they are likely to do or how they will react.

6.3.1.1 A framework for analysing competitors

The objective of analysing and profiling individual competitors is to understand how they might react to strategic initiatives or which strategic initiatives they might initiate (see [Figure 6.5](#)). Competitor profiling is an ongoing task especially important in fast-moving markets. An organisation normally does profiling for those few competitors, or groups of competitors, that it regards as a competitive threat, and therefore that warrant detailed analysis.

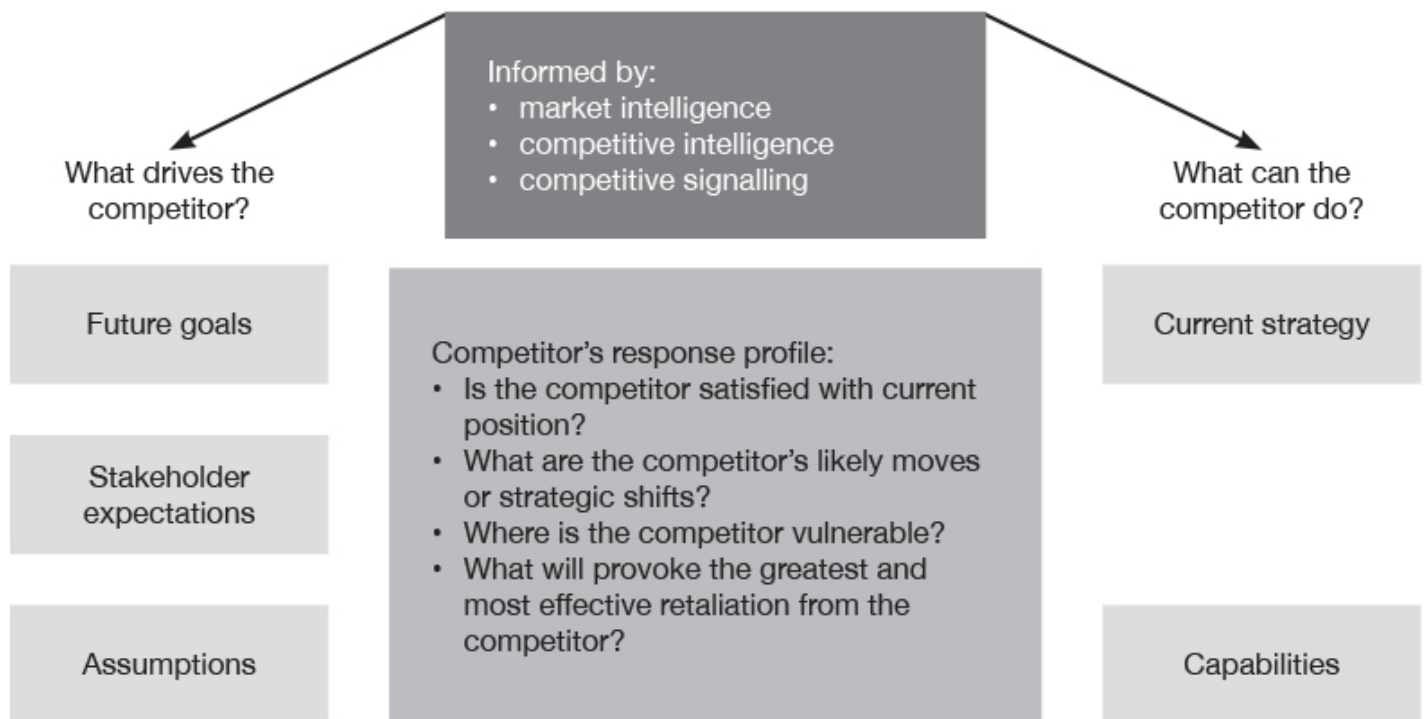
The basic input in competitor analysis is competitive intelligence (CI). Although most organisations gather some form of market intelligence informally, competitive intelligence refers to a formal programme of gathering information on competitors (see [Chapter 4 section 4.3](#) for a more detailed discussion of CI).⁵³

Using competitive intelligence as input, the first important aspect to ascertain is what drives competitors' actions. There are three important aspects:

- Their future goals
- Stakeholder expectations or demands
- Their assumptions about the industry.

However, it is also important to understand what the competitor is capable of. Here, the competitor's current strategy and core capabilities provide important clues to determine this. Using this framework should lead to an understanding of the competitor's strengths, weaknesses and response profile that could help to anticipate not only reactions to strategic initiatives, but also potential initiatives by the competitor.

Figure 6.5 A framework for competitor analysis⁵⁴



It is, however, not always possible to examine individual competitors only. In some instances, the analysis of strategic groups can provide an insight into the dynamics of competition in an industry.

6.3.1.2 Strategic groups

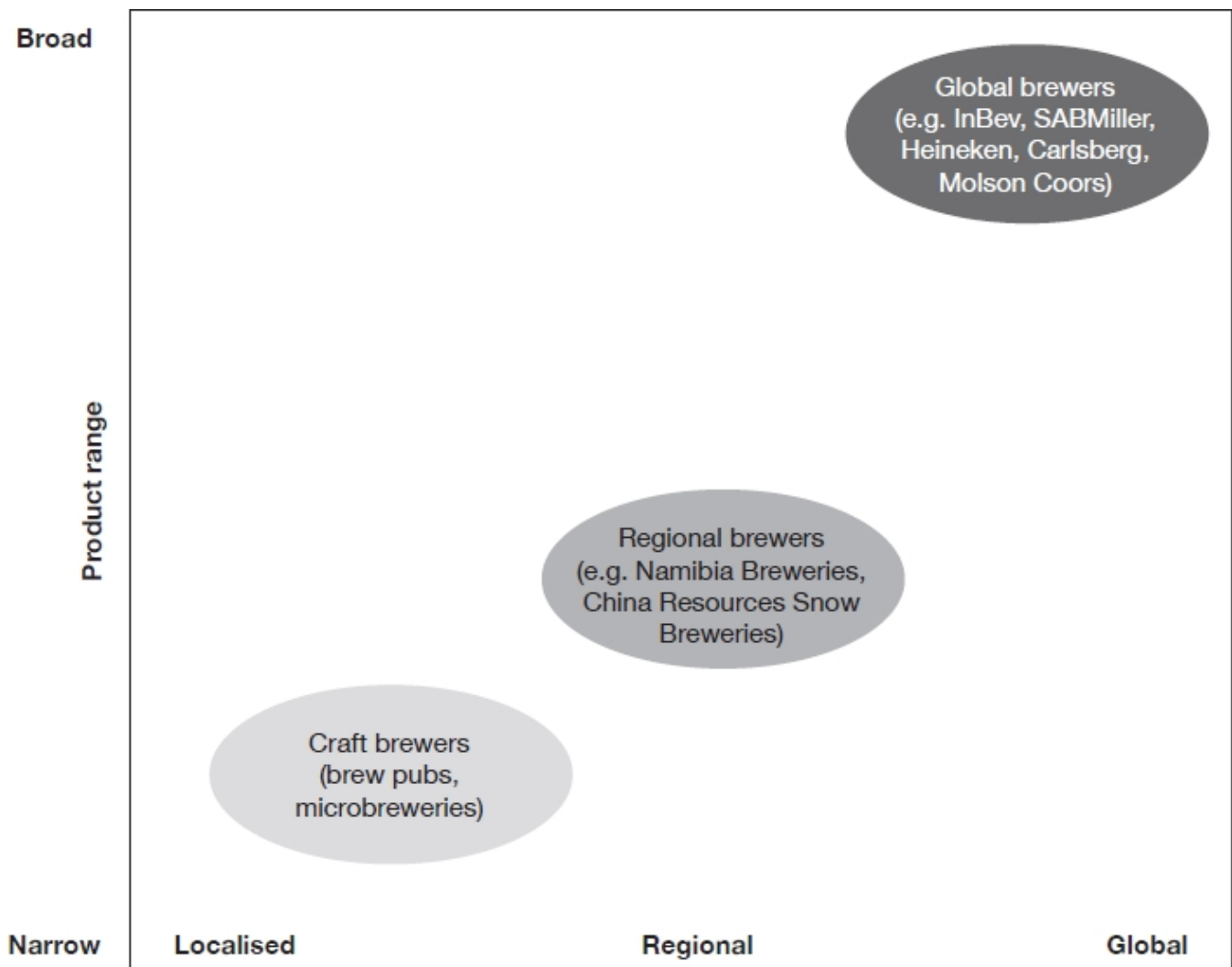
A **strategic group** is a cluster of organisations in an industry that are similar to each other, but distinct from other groups in the industry because they differ in one or more key aspects of their competitive strategy.⁵⁵ Fleisher and Bensoussan⁵⁶ suggested that identifying strategic groups depends on four key factors:

- *Mobility barriers*: These barriers determine the extent to which participants in one group can move to another group.
- *Competition within groups*: This is determined by:
 - » the number of groups in the industry and the distribution of market share between them
 - » the strategic distance between the groups
 - » the extent to which the market segments and differentiation of the groups overlap.
- *The impact of the bargaining power of buyers and suppliers*: This can influence strategic groups in two ways:
 - » First, strategic groups may all buy from the same group and sell to the same buyers. Therefore, the only difference may occur at the strategic level, and some groups may be more susceptible to bargaining power than others.
 - » Second, where different strategic groups use different suppliers and sell to different customers, this may add a dimension of differentiation based on bargaining strength.
- *Substitution*: Different strategic groups may be more susceptible to substitution depending on where in the value chain they focus. The emergence and success of direct short-term insurance companies, for example OUTsurance and Budget, that eliminate short-term insurance brokers may increasingly put pressure on brokers as a strategic group focusing on the sales and maintenance of policies.

A strategic group analysis of the global beer market is illustrated in [Figure 6.6](#). Global producers, dominated by large global players such as Anheuser-Busch InBev (AB InBev), Heineken, Carlsberg and Molson Coors have operations

and brands across the globe. They typically have one or more strong global brands, supported by a wide range of products ranging from strong regional brands (such as Castle in South Africa), to premium beers, to economy beers. For example AB InBev has Stella Artois, Fosters, Budweiser and Corona; Heineken has the Heineken brand; and Carlsberg the Carlsberg brand. Regional brewers such as Namibia Breweries (Nambrew) and China Resources Snow Breweries operate in a country or region. They have a more limited product range, but typically have at least one brand, for example Windhoek Lager or Snow, that is strong in their country or region. Craft brewers are often associated with a limited geographic area, such as a local pub selling its own beer or a microbrewery such as the Nottingham Road Brewing Company in the KwaZulu-Natal Midlands. With regard to their product range, they tend to rely quite strongly on the authentic and unique local characteristics and novelty of the product. For example, the Nottingham Road Brewery offers brands like Whistling Weasel Pale Ale, Tiddly Toad Lager and Pickled Pig Porter. It is easy to see that it would be difficult for a local microbrewer to compete with regional or global brewers. However, global brewers became global by acquiring regional brewers; for example, Heineken owns a share of Nambrew. The strategic distance between these two groups is thus relatively small.

Figure 6.6 Strategic group map of the global beer market



Note that this example is purely for illustrative purposes and is not based on rigorous analysis.

Organisations can use strategic group analysis in the following ways:⁵⁷

- *To identify their most direct competitors:* Competition will be most intense and direct within the strategic group, such as between regional brewers and their brands. For example, SAB's Castle Lager competes in Kenya with East African Breweries' Tusker Lager. Global brewers will compete for acquisitions to consolidate their positions further. Microbrewers will typically dominate in very small niche markets such as in a particular pub or town.
- *To consider where to compete:* Organisations need to consider what group or groups they would like to compete in and how possible it would be to move from one strategic group to another. Recently, SAB entered the craft beer market by announcing that it would be making ales at its No 3 Fransen Street Brewery (which was previously used as a test brewery).
- *To identify opportunities and threats:* Sometimes there may be open strategic spaces that present opportunities. However, intense and growing rivalry in certain strategic spaces may present a threat.

6.3.2 Customer analysis

The success or failure of organisations is closely linked to the extent to which they understand customer needs, and to what extent they address them.⁵⁸ This depends on an understanding of the various segments in the industry and customer commitment.

A market segment is a group of customers that has similar needs that are different from those of customers in other parts of the market.⁵⁹ While a detailed analysis of market segmentation methodology is beyond the scope of this book, a review of some principles is useful.⁶⁰

- *Segment uniqueness:* Segmentation should assist in identifying segments that respond uniquely to the strategic positioning of the organisation. Many different variables can be used in the process of identifying unique segments. Geography, income, other demographics such as age and education, buying behaviour, needs and attitudes are some of the variables that can be used alone or in combination to identify market segments. For example, by combining age, education and income into life stages, certain segments emerge that explain household earnings and expenditure patterns.
- *Segment attractiveness:* It is important to understand the various segments' relative attractiveness. This can be closely aligned with the organisation's strategic objectives. For example, if the organisation's main objective is profit, the margins that can be achieved in a segment are important. Segment attractiveness is normally determined by a combination of factors such as size, growth, profit margins and competitive intensity.
- *Key success factors:* In addition to understanding whether segments are attractive, it is important to understand customer preferences and how the organisation is or could be positioned based on those preferences. These preferences are also known as critical or key success factors. Key success factors are normally based on price, image, product quality, delivery, convenience and other customer preferences, and how the organisation compares to its competition with regard to these factors.
- *Scope of segmentation:* The number of segments to use is a matter of choice. The scope of segmentation is normally decided by two factors. First, the similarities of key success factors, and second, the presence of shared costs. It may be difficult for certain organisations to compete in segments that are too different from the segments in which they traditionally compete.

6.4 Summary

In this chapter we discussed industry analysis and intra-industry analysis. The section on industry analysis focused on defining the industry as a unit of analysis. This was followed by a discussion on the analysis of industry structure. Particularly important in this section was the idea of complementors as a means of increasing the value of the products and services of the organisation. This section also examined the importance of evolution in the industry as well as understanding how strategy has to change over time. Linked to this was the discussion on key success factors

and the idea that different industries and those in different phases of the life cycle require different approaches to strategy.

The second section started from the assumption that understanding industry structure and competitive forces may not be sufficient. In addition, the organisation needs to have a good understanding of both individual and groups of competitors. This allows an organisation to exploit specific opportunities, and identify and deal with specific threats. The same principles apply to customers. To target the most valuable customers, the organisation must segment the market, and assess and target specific segments.

The implication for organisations is that industry analysis is an ongoing task, not a single event undertaken every year or two. It is one of the key building blocks for developing a sound business strategy. Another important implication is that industry analysis is multidimensional. An organisation must not only understand the initiatives undertaken by the most obvious competitors, but must also develop a complete picture of the competitive threats and cooperative opportunities in the industry.

Unfortunately, many organisations seem to underestimate the importance of industry analysis and devote far too few resources to it. Information that will improve the strategic decision-making of an organisation cannot be bought or found on the internet. The quality of information and analysis makes all the difference to strategic insight and sound strategic decisions.

REFLECTION BOX:

Many organisations make use of loyalty programmes – Discovery Vitality, SAA Voyager, FNB e-Bucks and Pick n Pay's Smart Shopper card are but a few examples. What role do loyalty programmes play in industry positioning?

Opening case study questions

1. How will the key success factors of the automotive industry change in the future?
2. Would you describe the global automotive industry as an attractive one? Motivate your answer.
3. In the southern African context, should traditional car manufacturers take new competitors like Tesla seriously? Motivate your answer.

Discussion questions

1. Using the automotive industry as an example, explain how you would describe the industry if you were a local car dealership in Cape Town.
2. What are the key success factors in the electric car industry?
3. Visit the website: www.youtube.com/watch?v=mYF2_FBCvXw and watch the interview with Michael Porter on the five forces. Has watching the video modified your thinking about the five forces in any way?
4. Consider the extended framework for industry analysis (section 6.2.3.4). Do you agree with the inclusion of the regulator as an industry force? Motivate your answer.
5. Identify key success factors for each of the demand growth phases in the industry life cycle.
6. In what stage of the life cycle is the global automotive industry, and how is this affecting strategy in this industry?
7. Explain how you would go about conducting a competitor analysis of a car dealership.
8. Explain how strategic group analysis can be used to analyse competition in the telecommunications industry.
9. Explain how you would go about conducting customer analysis in the telecommunications industry.

Using knowledge and skills

1. Select an organisation of your choice and identify the industry in which it operates. Use both a narrow and a broad definition of the industry, and write down the advantages and disadvantages of each approach.
2. Identify an organisation with which you are familiar or on which you can obtain information. Write a briefing document for a competitive intelligence professional in which you outline questions you want answered about the organisation if you were to profile it as a competitor. Suggest sources for gathering information. Visit www.scip.org for ideas.
3. Select an organisation with which you are familiar and use the extended framework (section 6.2.3.4) to identify key threats and opportunities in the industry environment. Advise the management of the organisation on how they can use the information you have generated to their strategic advantage.

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Suggested websites

SCIP (www.scip.org) – The official website of Strategic and Competitive Intelligence Professionals.

Strategy+business (www.strategy-business.com) – A website with news focusing on strategy and business.

Strategic Management Society (SMS) (<http://strategicmanagement.net/>).

Management Innovation Exchange (<https://www.managementexchange.com/tags/gary-hamel>) – A website with new management ideas.

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CHAPTER 7

Analysing the internal environment

Peet Venter

LEARNING OUTCOMES

After reading this chapter, you should be able to:

- explain why resources and capabilities are strategically important
- explain how to assess the strategic value of resources and capabilities
- explain how an organisation can develop required resources and capabilities
- identify the strategic resources and capabilities of an organisation
- explain how an organisation can use its resources and capabilities to develop or maintain its competitive advantage
- explain the value chain of an organisation
- use the value chain to identify opportunities for cost or differentiation advantage
- appraise the resources and capabilities of the organisation as strengths or weaknesses.

KEY TERMS

benchmarking
capabilities
distinctive capabilities
dynamic capabilities
economic rent
individual skills and competencies
organisational routines
physical resources
resources
threshold capabilities
unique resources
value chain

OPENING CASE STUDY



Sasol: Innovation in the DNA¹

Sasol Ltd is an international integrated energy and chemical company based in South Africa, and is perhaps best known for perfecting the technology for making petrol and diesel from coal. This process started in the 1950s as a bid to make the government of the time less dependent on other nations for oil. Sasol was initially dependent on Germany and the US for the skills required to develop and implement the technologies required for making petrol and diesel from coal, but soon realised the necessity of investing to develop its own skills.

In the 1960s, Sasol began investing heavily in its own research and development (R&D) to start developing the chemical catalysts to effect the conversion from coal to oil to diesel/petrol, and to refine the processes further. It also started looking at some of the environmental issues that relate to the process.

R&D for companies such as Sasol is significantly costly, amounting to about 1% of turnover annually. While Sasol spends relatively more money on R&D than some comparable organisations such as Shell, the company has matured, and with it the percentage of money spent on R&D has declined to a more acceptable range. Sasol currently focuses on both the development of new technologies and supporting existing ones. Currently, Sasol's strong intellectual property portfolio includes in excess of 500 registered patent families. Within Sasol, there is a dedicated R&D team of more than 600 people, with over a third of them holding doctorates or master's degrees in engineering and science. Over the past 10 years, this team has been granted 210 patent families.

In addition to its in-house R&D function, based in Sasolburg and Secunda, Sasol also manages an extensive innovation network. The two R&D hubs are complemented by research teams in Enschede in the Netherlands and at the University of St Andrews in Scotland. In addition, it maintains strong relationships with research councils, such as the Council for Scientific and Industrial Research (CSIR), universities, analytical laboratories, the Department of Science and Technology, and the National Research Foundation (NRF) for research chairs, grants and postgraduate bursaries.

The spirit of innovation that has powered Sasol extends from its technological core to all aspects of managing a sustainable business, such as innovating to improve the efficiency of strategic business units.

Services and products have developed to address changing market needs and expectations. As a result, over the 60+ years of its existence, Sasol has built up an impressive array of innovations that form the core of its current and futures business. A few of these innovations are outlined below:

- The Sasol Slurry Phase Distillate (SPDTM) Process transforms natural gas into energy and chemical products, including transport fuels, base oils, waxes, paraffins and naphtha. The three-stage process combines three proprietary technologies. Natural gas is combined with oxygen to form a syngas, which is then subjected to a Fischer-Tropsch conversion, resulting in waxy syncrude. Finally, this is cracked down to produce the end product. The strength of the Sasol SPDTM process is not simply in the inherent quality of the three component technologies but more importantly how they are combined and integrated to increase efficiencies and optimise output, a result of Sasol's 60 years' experience in synthetic fuels production.
- In 1997 Sasol Technology Research and Development began research on the selective trimerisation of ethylene to 1-hexene. This led to the development and patenting of six trimerisation catalyst systems. A ground-breaking innovation was made in 2002 with the discovery of a tetramerisation catalyst that could make 1-octene in high selectivity. This was considered impossible by international experts in the field. A first-of-a-kind plant was commissioned in Lake Charles, Louisiana, in 2013.
- Sasol's environmental science and engineering services and products include water and waste water processing, atmospheric modelling and solid waste handling.
- Sasol is involved in developing capabilities in alternative energy, including the processing of terrestrial biomass as well as an emerging competence in concentrated solar, photovoltaics and energy storage.
- Support services include the design and execution of small projects, the operation of pilot-scale and semi-commercial pilot plant units covering a wide range of technologies, advanced process control systems and process safety management.
- Fuels technology includes product applications research and plant/market product technical services on a range of products including transport fuels (petrol, diesel and jet fuel), industrial heating fuels, lubricants, gas and road-binding materials. Areas of expertise include new product and application development, product fit for

purpose testing, alternative fuel development and certification, combustion research, exhaust emission testing, fuels blending, the interaction of fuels with fuel systems and problem solving.

Sasol has been a frontrunner in technological innovation and excellence since their inception in the 1950s. For over 60 years, they have developed and commercialised innovative energy-related technologies, first with coal as a feedstock, then with gas and, into the future, with renewable energy sources. Only time will tell if they can use their long and illustrious history as a springboard for similar success in the future.

Overview

In the Opening case study *Sasol: Innovation in the DNA*, we can see how Sasol is constantly looking for new sources of competitive advantage as its legacy products (such as 'oil from coal') mature and decline. In this process, some elements remained constant, but Sasol had to develop new capabilities as it grew from a government project, to a commercial business, to a global player in energy and related chemicals. This required internal analysis to identify the organisation's strengths and weaknesses as a basis for competitive strategy. In this regard, two concepts play a prominent role in strategy literature:

- The idea of resources as the basis for competitive advantage, namely the resource-based view (RBV)
- The analysis of comparative strengths and weaknesses.

This chapter uses these two concepts as a basis for exploring ways of identifying comparative strengths and weaknesses.

7.1 Introduction

Many organisations use the SWOT method, typically by brainstorming, to identify opportunities and threats in the external environment (see [Chapters 4 and 5](#)), and strengths and weaknesses in the internal environment. SWOT is an acronym for strengths, weaknesses, opportunities and threats. However, just producing a list of strengths and weaknesses has marked shortcomings in establishing a strategy for the future that is aligned with the internal environment of the organisation. It is far more useful to have a framework to conduct internal analysis. In this regard, the analysis of resources has been widely accepted in strategy literature. Resources in this context refer to the assets, skills and capabilities over which the organisation has control.²

The rise of the so-called resource-based view (RBV) of the organisation springs from the strategic importance of understanding why organisations differ from each other, and why certain organisations are more successful and more profitable than others.³ Competitive advantage, or the lack thereof, is generally better explained by understanding the distinctive resources and capabilities⁴ of the organisation than by understanding its external environment only. In fact, the rise of the RBV is at least partly a reaction to the almost exclusive focus on the role of the external environment in strategy during the 1980s.⁵ In addition, empirical evidence of the impact of industry on business success is inconclusive.⁶

The first part of the chapter deals with the importance of **resources** and **capabilities** in strategy, while the second part deals with their identification. The last part of the chapter deals with the appraisal of resources and capabilities, and the identification of strengths and weaknesses.

7.2 The strategic importance of resources and capabilities

The acceptance of the RBV rests on three important premises:⁷

- Resources determine the *strategic direction* of the organisation. An understanding of distinctive resources and capabilities can help the organisation determine what it is capable of doing, rather than focusing on what its current business is.
- Resources are the *primary source of profit* for the organisation. Profitability is determined by two factors, namely the *attractiveness of the industry* in which the organisation competes, and its ability to establish a *competitive advantage* over its rivals. While industry attractiveness is generally the domain of industry analysis, the RBV can provide significant insights as to why certain organisations are more successful than others – in other words, why some organisations have a competitive advantage over others.
- *Industry positioning* alone does not explain differences in profitability among similar organisations with similar products in the same industry.

The next question to explore is what makes resources valuable, and how long this advantage can be sustained. Various authors use the terms '**economic rent**' and 'rent' interchangeably to describe the ability of resources to attract income. The value of a resource is therefore ultimately determined by its ability to generate rent. There are two types of economic rent commonly mentioned in strategy literature:⁸

- *Ricardian rents* (named after economist David Ricardo) are rents associated with unique resources and capabilities. For example, Apple's iOS software provides Apple with proprietary mobile phone software that can be used to develop applications ('apps') for the iPhone and iPad that may contribute to exceptional returns. There are also examples of monopoly rents that result from skilled investment and market strategies. For example, Microsoft Windows as a widely accepted standard for operating system software allows Microsoft to earn monopoly rents from its flagship product.
- *Schumpeterian rents* (named after economist Joseph Schumpeter) are especially prevalent in volatile markets such as certain high-technology ones. Schumpeterian rents refer to those returns appropriated by the organisation because of a new or innovative product that allows it to charge a price much higher than the cost of production. These rents are normally unstable and will eventually disappear. For example, in the cellular handset market the first competitor to build a commercially available cellular phone with a built-in camera was the Sharp Corporation in Japan in 2001. This advantage lasted only until the first Nokia with a built-in camera was launched in 2002. By 2006, half the cellular phones in the world had built-in cameras and by 2009, Nokia was the biggest manufacturer of any type of camera.⁹ Today, there are very few models of cellular phones that do not have cameras, and many of the more upmarket ones have cameras with quality as good as or better than that of smaller handheld cameras.

Figure 7.1 provides a summary of the factors that determine the value of resources. In short, the value of resources is determined by the following:

- The extent to which resources are a viable source of competitive advantage
- The extent to which such a competitive advantage is sustainable over time
- The extent to which the organisation is in a position to appropriate the returns generated by the resources
- The extent to which resources can be exploited for future growth.¹⁰

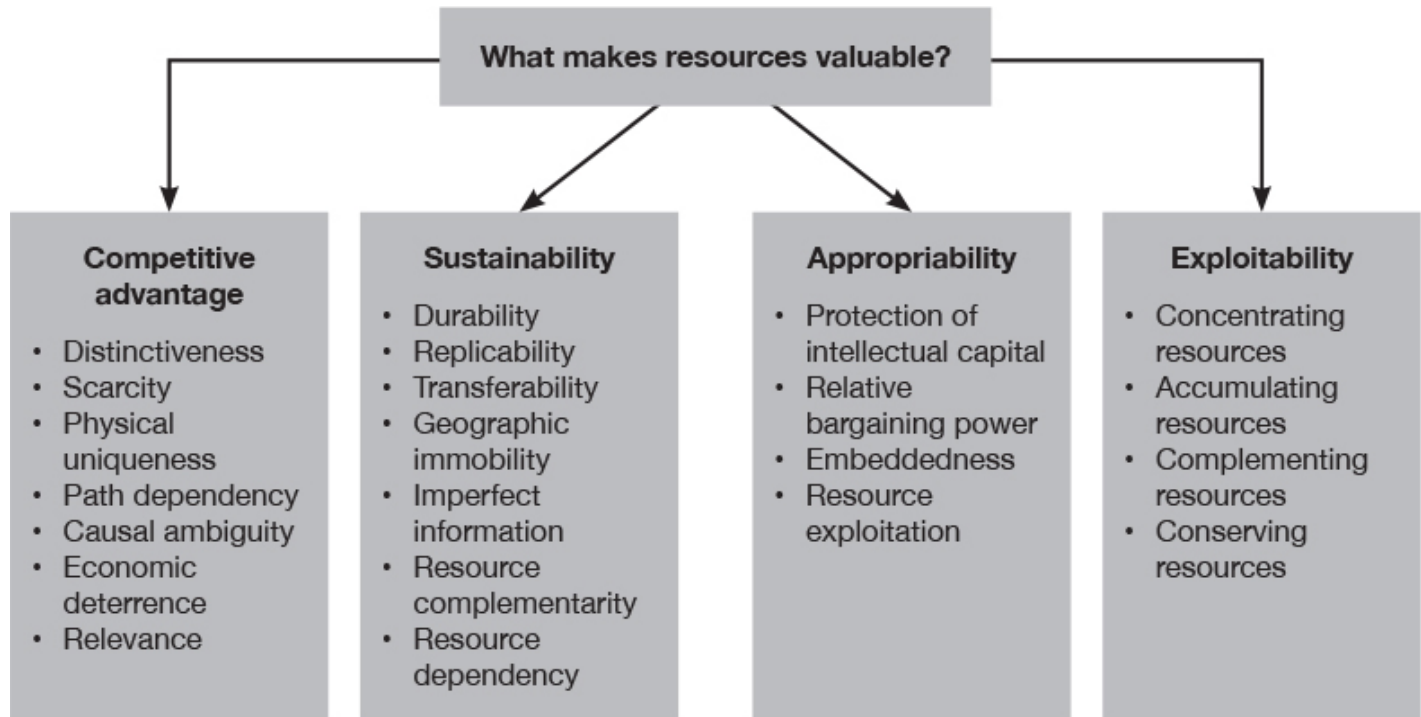
These concepts are discussed below.

7.2.1 Competitive advantage

If a resource meets customer needs at a price that customers are willing to pay, there is a demand for it. However, the resource is more valuable if it can establish a *competitive advantage*. This means that the resource can assist the organisation in meeting customer needs better than the competition can. Thus the concept of a *distinctive capability* and its role in creating competitive advantage becomes important in understanding the value of resources.

A resource is also more valuable if it is *scarce* – in other words, not every organisation possesses it or can possess it, and it should also be *relevant* to the key success factors in the market. Thus resources can only lead to competitive advantage when they are unique and hard to come by. For example, when cellular telephony was introduced in the early 1990s, many countries initially only licensed one or two cellular operators. This provided a *unique resource* and competitive advantage to the licensed cellular operators.

Figure 7.1 The determinants of resource value



There are four determinants of the scarcity of resources:

- *Physical uniqueness*: In the first place, resources can be physically unique. Real estate, mineral rights, government licences and patents are examples of resources that cannot or may not be physically copied.
- *Path dependency*: A second source of scarcity is path dependency. Certain resources are built over time in ways that cannot be replicated. Brand image, organisational culture and company reputation are examples of resources that cannot be copied unless exactly the same sequence of events is followed that led to the original resource being created in the first place.
- *Causal ambiguity*: In many instances, it may be difficult, or even impossible, for competitors to work out exactly what the truly valuable resource of a rival is or how to copy it.
- *Economic deterrence*: The fourth determinant is economic deterrence, which occurs when economic realities make it unattractive for rivals to invest in certain resources. This may be in evidence when unfavourable market conditions occur, for example low market potential, or where the likelihood of an aggressive response to competition scares off potential imitators.

7.2.2 Sustainability

To create a sustainable competitive advantage, a resource must be in short supply over a period of time – in other words, it must be both scarce and durable. In addition, the organisation should be able to replicate the resources and capabilities in other markets or products. The organisation must also protect the resources from imitation by rivals

by ensuring that they are not too easily transferable. However, they must be transferable enough for the organisation to replicate.

There are four barriers to transferability that will make it difficult for competitors to successfully transfer resources for their own benefit:

- *Geographic immobility*: In the first place, resources may be geographically immobile, for example mineral deposits.
- *Imperfect information*: This means that competitors may find it difficult to obtain sufficient information to evaluate resources and capabilities, and may then end up not being sure what the appropriate price is to pay.
- *Resource complementarity*: Separating a resource, such as a brand, from its context can cause a loss in value. Thus the resource may be dependent on its context and complementary resources and will be less productive in a different setting.
- *Resource dependency*: This also plays a key role since capabilities are combinations of resources that work together. Separating one aspect, for example a team of people, from the whole may reduce its efficiency.

To achieve sustainability, organisations have to exploit or leverage resources, and at the same time protect them from imitation by competitors.

7.2.3 Appropriability

The third critical determinant of the value of resources centres on the question of who captures the value generated by resources. Generally, the owner of the resource captures most of the value it creates. For example, Microsoft owns the Windows operating standard, and although it may license the software to hardware vendors or even to software developers, most of the value created flows to Microsoft. This concept is referred to as *appropriability*, and it explains why internally developed resources are generally more valuable than those bought or used under licence. The more embedded the resources are within the organisation, the greater the ability of the organisation to appropriate the value flowing to them.

However, if the value is seated, for example, in one or a few individuals, they will be able to attract much of the value created by the resources. For example, if a star soccer player moves to a new team, and his move creates more value for the team such as increased gate revenues and sponsorships, it is likely that the player will be able to attract a substantial portion of this value.

There are four aspects that determine the potential of an organisation to capture the rent generated by its resources and capabilities:

- *Protection of intellectual capital*: First, to what extent can the intellectual property and intellectual capital of the organisation be protected against imitation?
- *Relative bargaining power*: This can play a role when complementary services have high bargaining power as they can then appropriate more of the rent. Think of the massive salaries that some movie stars are able to command. This is due to their power to draw crowds to the box office, which gives them bargaining power.
- *Embeddedness*: In some instances, the resources and capabilities are so embedded in the organisation's structures and processes that they cannot be separated, causing the organisation to be in a position where it can appropriate most of the value generated.
- *Resource exploitation*: Also important when considering this aspect is the issue of resource exploitation, which is discussed in the next section. Some organisations (such as Disney, in the Case example on page 215) are better at leveraging their resources, which enables them to capture more of the value generated.

7.2.4 Exploitability

An organisation's ability to exploit or leverage its valuable resources and capabilities lies at the heart of the RBV. (Also see [Figure 7.4](#).) Hamel and Prahalad suggested that resources can be leveraged by concentrating, accumulating, complementing and conserving as discussed below.¹¹

7.2.4.1 Concentrating resources

Concentrating resources refers to the principle of the selective allocation of resources. This involves three elements:

- *Converging* resources on a few selected strategic goals that will contribute to the attainment of the organisation's vision
- *Focusing* the efforts of each organisational unit on single priorities sequentially, which prevents the dilution of resources by trying to do too many things at the same time
- *Targeting* those activities first that have the highest impact on customers' perception of value.

Lack of concentration can lead to poor performance and resource wastage.

7.2.4.2 Accumulating resources

Accumulating resources refers to the principle of building up resources as quickly as possible using the following methods:

- *Mine experience* to learn as quickly as possible. This involves activities like joint problem solving in forums such as quality circles, and benchmarking against best practice.
- *Borrow* from other organisations by means of arrangements such as strategic alliances, joint ventures and outsourcing activities. The Joule electric car developed in South Africa was shelved when the company could not find suitable partners to mass-produce the vehicle,¹² and they did not possess the resources themselves. In such a case, a strategic alliance with a suitable production partner might have saved the Joule.

7.2.4.3 Complementing resources

Complementing resources refers to the process of increasing the value of resources by linking them to complementary resources and capabilities:

- *Blending* by, for example, linking technical or R&D capabilities to the marketing capabilities required to get the product to market
- *Balancing* to ensure that limited resources and capabilities in one area do not limit the value of resources and capabilities in other areas. The South African-developed Joule electric car was by all accounts a very promising product, but its lack of mass production capabilities eventually caused the project to be abandoned by the South African government.¹³

7.2.4.4 Conserving resources

Conserving resources refers to the principle of using resources and capabilities to the fullest extent:

- *Recycling*: Resources can be recycled through different products, markets and product generations (see the Case example below on Disney).
- *Co-opting*: Resources can be co-opted by collaborating with other companies.

CASE EXAMPLE: Growing the magic kingdom

When Disney acquired comics publisher Marvel and science fiction franchise *Star Wars*, it was obvious that the marketing prowess of Disney would be brought to bear on these acquisitions. So far, we have seen this in a number of different ways:

- Leveraging characters such as Iron Man, Spider-Man and Han Solo through multiple products (computer and console games, films, graphic novels, and toys)
- Collaborating with gaming studios and toy manufacturers to co-opt resources and capabilities that Disney does not possess
- The creation of new storylines for existing characters and prequels for existing storylines, such as *Rogue One: A Star Wars Story*
- Disney ventured into new media such as television series (e.g. *Marvel is Agents of S.H.I.E.L.D.*) and product expansion (such as *Toy Story Land* and *Star Wars Galaxy's Edge*).

Disney paid approximately \$4 billion for the Star Wars franchise and Lucasfilm Ltd. The deal closed in December 2017, nearly 7 years ago.¹⁴

When organisations do not have the resources to exploit, their only option is to acquire the resources. This is the focus of [section 7.2.5](#).

7.2.5 Developing resources and capabilities

When organisations decide to enter new markets or introduce new products and services, and they do not have the resources and capabilities to match the required key success factors, they need to acquire them in some way.

Christensen suggested that there are three ways in which organisations can do this:¹⁵

- *Acquisition*: An organisation can acquire a different organisation that does possess the required resources and capabilities. This is often a cost-effective way of obtaining resources and capabilities. However, it can also prove to be a costly mistake if the acquired resources and capabilities cannot be successfully integrated into the acquiring organisation. For example, the merger between American automotive giant, Chrysler, and the German icon, Daimler-Benz, had to be disbanded when the merged company, DaimlerChrysler, failed to leverage the value of the merger.
- *Internal creation*: Creating new capabilities internally is a possibility, but it is also a risky proposition. Often the capital raised, new people hired and new processes created are simply absorbed into existing processes and structures, and disappear without a trace. In 2008, Telkom SA sold its 50% share in cellular provider Vodacom and announced that it would invest R1.7 billion in building its own mobile business (Telkom Mobile). By 2013, it was clear that Telkom had made a mistake, and that the Telkom Mobile business was not succeeding to the extent that it had hoped or anticipated it would.¹⁶
- *Creation of a spin-out organisation*: Capabilities can also be created through a spin-out organisation where a separate, small start-up organisation is established as a mechanism for developing the required resources and capabilities. This type of venture only has a chance of success where the CEO oversees the start-up closely, ensures that it has the required resources, and where it does not have to compete head-on with the mainstream organisation and projects for funding. For example, when Telkom SA had the opportunity to enter the cellular market in 1993, it formed Vodacom SA, but due to government's insistence that the Telkom shareholding be limited to 50% of the new venture, Vodacom was established as a spin-off. The shareholding agreement contributed greatly to Vodacom's independence, and offered the organisation access to resources such as the marketing and branding knowledge of another key shareholder at the time, the Rembrandt Group. It is unlikely that Vodacom would have been as successful as it has been if it had simply been established as an operating division of Telkom.

CASE EXAMPLE: Using resources and capabilities to establish competitive advantage

Chris Zook from Bain & Company¹⁷ describes four pillars of strategic advantage and renewal that were identified during 20 years of studying successful corporate transformations:

- *Unique resources*: The importance of unique resources is underscored by the transformation of Marvel Entertainment Inc., which resulted in Marvel being acquired by Disney for \$4 billion in 2009. Marvel based its renewal on its strongest unique assets, namely a loyal customer base; a stable of 5 000 comic-strip characters, for example Spiderman; a library of 30 000 stories that have been market tested; and the Marvel brand. Marvel recently produced a breakout hit with the critically acclaimed *Black Panther* movie (distributed by Walt Disney Studios Motion Pictures), with box office takings of \$1.3 billion.¹⁸
- *Dynamic capabilities*: These rely on 'following the money'. In the case of Marvel, the organisation had to shift from focusing on channels such as magazines to proprietary content, for example the copyright on characters and stories. The proprietary content then shifted from analogue media such as graphic novels, to digital media such as TV, films and gaming.
- *Resource replication*: One of the ways to create value from resources is to replicate or repeat a successful formula in new situations or markets. For example, Marvel can make a successful character or story available on film or DVD, in a television series, in a computer game, game console and toys. The organisation can also use characters in multiple situations and storylines; for example, the *Iron Man* and *Spider-Man* movie franchises have resulted in multiple successful sequels. Disney has already indicated its intentions to produce the final *Star Wars* trilogy with young director JJ Abrams at the helm, and has announced a deal with gaming producer Electronic Arts to produce *Star Wars* games.
- *Hidden resources*: In some instances, hidden assets can be adapted to a new environment and can create value that was not previously recognised. For example, Apple Inc.'s software interface and young, loyal customers ultimately led to a differential advantage in the music download business.

These findings support the importance of unique resources and dynamic capabilities in establishing competitive advantage.

7.3 Identification of resources and capabilities

Many organisations are good at identifying the physical resources that they own, and can give detailed accounts of their finances, production facilities, information technology and other physical assets. However, they are often unsure of the value of their intangible assets, and even more so about the true value and sustainability of their capabilities. This section explores the different types of resources and capabilities as a basis for identifying resources and capabilities.

Because of the differences between resources and capabilities, we will consider their identification separately. [Section 7.3.1](#) addresses the identification of resources, while [section 7.3.2](#) focuses on the identification of capabilities. [Figure 7.2](#) provides a summary of the RBV framework for identifying resources and capabilities.

7.3.1 Identifying resources

Any organisation possesses certain strategic resources. These can generally be categorised into three broad classes, namely physical resources, intangible resources and human resources.

7.3.1.1 Physical resources

Physical resources are typically the tangible assets that appear on the organisation's balance sheet. They include property, raw material, production facilities, and many other resource categories. Organisations can use tangible assets to create value either by using these assets more economically or by using them more profitably.

7.3.1.2 Intangible resources

Intangible resources include brand value, culture and intellectual capital. Intellectual capital is an important part of intangible resources, and includes patents, brands, business systems and customer databases.

In most successful organisations, the value of intangible assets such as brand value far outstrips that of physical assets (see [Figure 7.2](#)). Thus intangible assets play an important role in creating value and establishing competitive advantage. In an economy based on knowledge, intangible assets and intellectual capital are the major resources of the organisation.¹⁹

Intangible assets (even brand value) are often not extensively measured nor reported in organisations' balance sheets. The value of intangible assets lies in the fact that, unlike tangible assets, they grow in value the more they are used.²⁰ Intangible assets, such as brand names, can be leveraged in value creation by extending the product and market scope of the brands.

7.3.1.3 Human resources

Human resources refer to the **individual skills and competencies** to which the organisation has access. Human resources provide the productive services that all organisations require to survive and prosper.²¹ Human resources are also unique in the sense that organisations can never own them. Through their individual skills, knowledge, and learning and thinking abilities, human resources can contribute significantly to value creation in the organisation.

Collectively, organisational culture is determined by the leadership and employees of the organisation and can, in some instances, provide a valuable resource and defence against competition and value erosion.

7.3.2 Identifying capabilities

Resources as such are not particularly productive, but add value when they combine to form unique capabilities. The term 'organisational capabilities' refers to the organisation's capacity to combine resources into productive activities.²² Therefore, organisational capabilities are a higher-order resource than mere factor inputs, such as raw materials, that can be relatively easily acquired. Capabilities represent complex combinations of assets, people and **processes** that organisations use to transform inputs into outputs. This suggests that organisational capabilities require highly complex interactions between people and people, and between people and resources, as shown in [Figure 7.2](#).²³ [Figure 7.2](#) also illustrates another important concept, namely the hierarchy of resources. Some resources are worth relatively little on their own, but in combination with other assets and resources they create valuable capabilities.

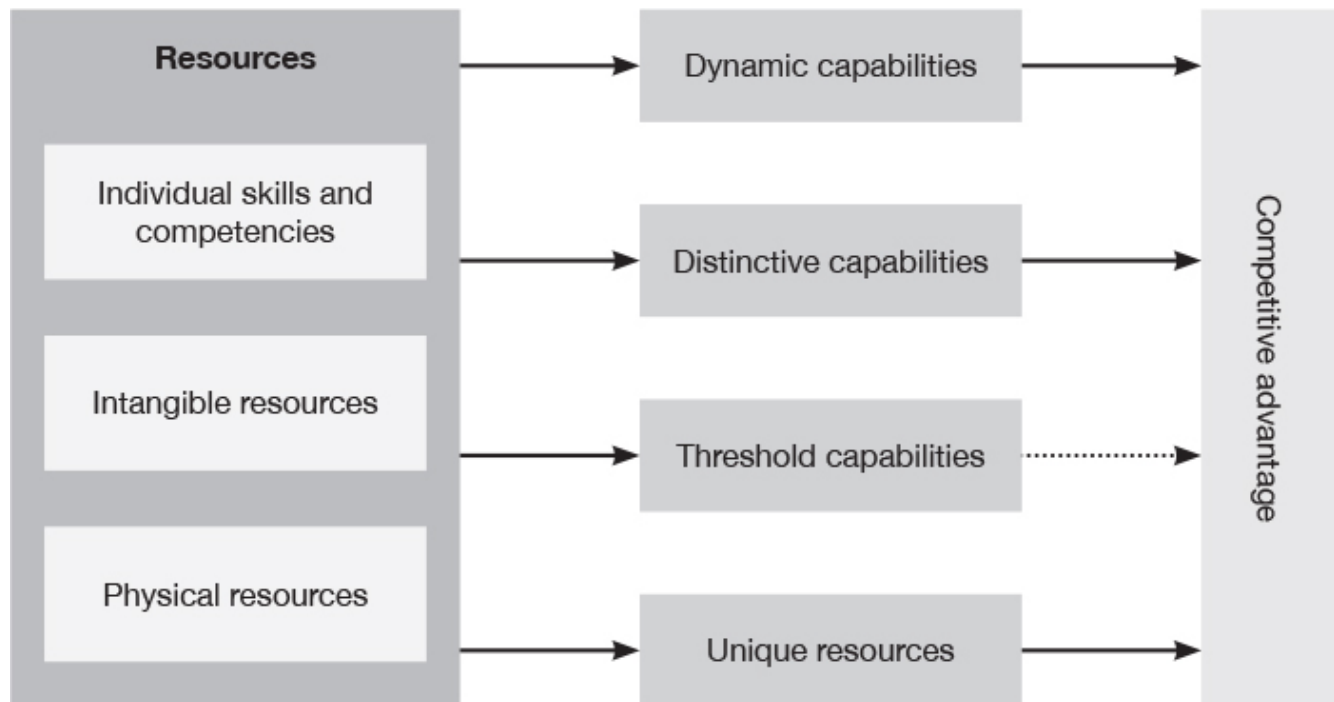
7.3.2.1 Types of capabilities

There are three broad categories of strategic organisational capabilities, namely threshold capabilities, distinctive capabilities and dynamic capabilities.

Threshold capabilities

Threshold capabilities are the minimum capabilities needed by the organisation to compete in a market.²⁴ They do not provide competitive advantage since all competitors need them. For example, all producers of fast-moving consumer goods need effective distribution channels and logistics to get their products to market.

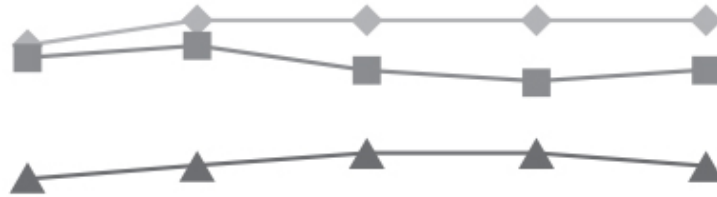
Figure 7.2 A summary of the RBV



CASE EXAMPLE: Capitec and FirstRand's superior return on equity²⁵

For the past decade, Capitec Bank and the FirstRand Group (which houses First National Bank (FNB) and Rand Merchant Bank) have consistently outperformed the rest of the banking industry in terms of their return on equity (ROE), a key measure of banking performance (see graph below). It is no coincidence that both of these organisations have certain distinctive capabilities that drive their success. Capitec is arguably the only bank to have addressed the low-income market in South Africa successfully and profitably by offering simple, affordable and accessible banking to lower-income customers. Their success rests on their innovative business model that enables higher accessibility and lower costs than their competitors. On the other end of the spectrum, FNB offers innovative, technology-driven banking and complementary services (such as the e-Bucks loyalty programme) that enables the organisation to develop long-lasting and value-adding relationships with their customers.

ROE (%)



	2014	2015	2016	2017	2018
—◆— Capitec	25%	27%	27%	27%	27%
—■— FirstRand	24%	25%	23%	22%	23%
—▲— Other banks (average)	14%	15%	16%	16%	15%

Distinctive capabilities

Distinctive capabilities are also referred to by some authors as **core competencies**.²⁶ These capabilities are unique and valuable, and provide a basis for competitive advantage. Rivals will generally also find distinctive capabilities difficult to imitate. They are important because they require organisations to focus not only on what they do well, but also on what they do better than competitors. Hamel and Prahalad defined distinctive capabilities (core competencies) as those that:²⁷

- make a disproportionate contribution to customer value or the efficiency of delivering that value
- provide a basis for replication, i.e. entering new markets or creating new market offerings.

Distinctive capabilities form the basis of strategic innovation – the ability to develop new markets and products. Note that successful organisations generally have only a few distinctive capabilities, and that organisations may end up with no distinctive capabilities, and accordingly no competitive advantage.

Dynamic capabilities

Dynamic capabilities refer to those capabilities that enable the organisation to develop new ones. This describes the organisation's ability to integrate, build and reconfigure internal and external competences to address rapidly changing environments.²⁸ Since most sources of competitive advantage are temporary, organisations that are able to develop new capabilities will have an advantage over their rivals in the long run. Dynamic capabilities can be summarised as comprising three underlying capabilities. Firstly, the ability to make sense of opportunities and threats in the external environment; secondly, the ability to seize opportunities or respond to threats by altering the operating capabilities and resources of the organisation; and thirdly, maintaining an organisation's competitive advantage by ensuring ongoing alignment between its resources and capabilities and the changing demands of the environment.

Dynamic capabilities are often described in vague terms that make them hard to identify in practice. Eisenhardt and Martin tried to overcome this limitation by describing them as identifiable and specific routines:²⁹

- *Resource integration*, such as product development routines, where managers combine their varied skills and functional backgrounds to create revenue-producing products and services
- *Strategic decision-making*, which is a dynamic capability in which managers pool their various business, functional, and personal expertise to make the choices that shape the major strategic moves of the firm
- *Reconfiguration of resources* within firms, by copying, transferring and recombining resources, especially knowledge-based ones
- *Resource allocation* routines, which are used to distribute scarce resources such as capital and manufacturing assets from central points within the hierarchy, such as a corporate head office
- *Coevolving*, which involves the routines by which managers reconnect webs of collaborations among various parts of the organisation to generate new and synergistic resource combinations among organisations
- *Patching*, which is a strategic process in dynamic markets that centres on constantly remapping the organisation in such a way that it matches up to changing market opportunities. It can take the form of adding, splitting, transferring, exiting or combining chunks of businesses.³⁰ Alphabet (formerly Google) is an example of a company that is constantly patching to match market needs. Google Maps, YouTube, Chrome and Android are all part of the patchwork of tightly focused businesses that make up the Alphabet family, while the company is also experimenting in health technology with companies like Life Sciences (that works on glucose-sensing contact lenses), and Calico (focused on longevity).³¹
- *Knowledge creation* routines, whereby managers and others build new thinking within the firm
- *Alliance and acquisition* routines, which bring new resources into the firm from external sources
- *Exit routines* that eliminate resource combinations that no longer provide a competitive advantage. As markets undergo change, it is necessary to adapt and eliminate resource combinations that no longer provide a competitive advantage.

We will now explore three frameworks for identifying distinctive capabilities, namely functional analysis, Porter's **value chain**, and the architecture, reputation and innovation framework. Functional analysis and Porter's value chain are commonly used frameworks for identifying capabilities. These two frameworks are subsequently discussed along with a discussion of three key capabilities, namely architecture, reputation and innovation. In [section 7.3.2.5](#) we discuss the important relationship between knowledge and capabilities.

STRATEGY IN ACTION: How Discovery keeps innovating – the perspective of CEO Adrian Gore³²



When we formed Discovery, we asked the question 'How do you innovate and build a health-insurance system that can work in this kind of environment?'

Our gut instinct was that if you can make people healthier, you can offer more sustainable insurance. It turns out that three lifestyle choices (smoking, poor nutrition, and poor physical activity) contribute to four conditions (diabetes, cancer, heart disease, and lung disease) that drive over 50% of mortalities every year. So, lifestyle choices are fundamental to any social-insurance system. Behavioural science tells us that people need incentives to make a change. But that wasn't universally known at the time; we were just a start-up acting on a hunch.

When we were starting out, a massive gym chain approached us with the idea to sell our health insurance to their membership base—a classic cross-sales strategy. Our breakthrough came when we flipped this idea around: What if you can use the gyms when you get your insurance from us? But we couldn't figure out how to afford it.

Then we thought, 'Well, what if you earn points by doing healthy things? Then those points give you access to cool rewards and a discount on your premium?' That idea was the catalyst for everything, which I think is true of

innovation. It's a moment in time. It's not always a revelation in a laboratory. In my experience, it's right there in front of you. Once you get it, you run with it.

The genesis of Vitality

That initial idea was the genesis of our Vitality program, which has evolved into a complete wellness system that tracks everything from physical activity to nutrition over the course of a person's life. For instance, customers earn points by logging their workouts with fitness devices from Nike+, Fitbit, and others. These sync up with Vitality directly, through a computer, or with mobile apps on smartphones. When you go to our partner grocery stores, the healthy food is clearly demarcated on the shelf, and you get a 25% discount at the register when you swipe your Vitality card. When we first launched the program, we were criticized for wasting healthcare dollars on incentives, but customers went berserk for it.

Today, Vitality is the foundation of our business model, driving every one of our offerings. Take life insurance. It seemed to us that the system was broken. What happens when you fill out an application? They basically cut you in half for a detailed health analysis—blood tests, medicals. From that, they derive a very sophisticated rating that often comes with a rate guaranteed for life. But how does it make any sense to set a rate at a certain point in time, when a change in your behaviour could shift the underlying risk throughout your life?

So, we decided to offer a new, competitive model. The beauty of it is the shared value it creates for our customers, our company, and society. Our customers are given an incentive to become healthier, lowering their premiums. And we are able to operate with better actuarial dynamics and profitability.

In 2001, we rolled out Discovery Life on this basis, and soon became the number one provider of life insurance in South Africa. Our competitors have been around for more than a hundred years, but they don't have Vitality. If you understand the scale of the program, you can see it's not a capability that could easily be copied. We log 70 000 gym visits per day; people have bought a hundred million dollars' worth of healthy food in the last few years through our structure. Vitality has provided a competitive advantage that has served us well both inside our home country and beyond it.

The flexibility of Vitality's structure allows us to enter markets where we could never become the main insurer; the barriers to entry are just too high. We can instead partner with established insurers in those markets by scaling our Vitality model as needed. In the United Kingdom, we worked with Prudential initially but recently acquired full ownership of our health- and life-insurance businesses there. In the Asia-Pacific region, we are now rolling out our model across some of AIA's markets. We also have an equity stake in Ping An Health, working with one of China's largest insurers, Ping An. Just this year, we've established a new partnership with John Hancock Life Insurance in the United States, and we're developing one with Generali in Europe, as well.

The model that keeps on giving

Just as Vitality has allowed us to expand geographically, it has also been an additive model that can accommodate other dimensions.

We saw an opportunity to develop a standard vehicle-tracking device that monitors not only the location of a car but also how people are driving—the acceleration and G forces. Rory Byrne, a South African engineer who designed cars for the racing driver Michael Schumacher, has helped us with the telematics to build a Formula One-level analysis of a person's driving behaviour. But that requires a complex black-box installation in the car. So, we've been working with a company founded by two MIT professors to build an application that also works directly through your smartphone. It has given us some amazing insights into what we call 'driving DNA.' We can immediately tell if someone else is driving your car or if you've gotten into an accident, just by the deviation in data, which raises a red flag. The Vitality Drive program allows us to track our customers, to reward them for good driving with a lower premium and a discount on gas, and to provide real-time emergency assistance.

A cycle for innovation

We're often asked, 'Can you keep innovating?' The truth is, I find that the more you innovate, the more you can innovate. Most innovation in companies is event based. A competitor comes up with something, and the company responds. We do the opposite. Our leaders are always on a treadmill to create and launch new ideas. For example, every year we have a rock-star launch where we're presenting something new to thousands of our

intermediaries who own sales. Our guys know the date is booked. The concert's happening. You just better write the music.

To push ourselves to find the next idea, we have an internal competition every year called Inspiring Excellence, where our top one thousand leaders break into teams of two to four people and work on new concepts. Throughout the year, we hold contests until we've narrowed down to the top five teams, who present at our annual management conference. Even ideas that don't win often prove to be winners later on, when we roll them out. This program provides us with a strong inventory of possibilities, which are continually replenished.

Twice a year, our remuneration committee looks at each business and gives it an innovation score. So, the take-home bonus of a thousand people is based on a subjective review of the success of their launches. But even beyond that pool, all our employees are involved in this time-based cycle, working on projects. Across the organisation, there's a natural metronome of our innovation.

Questions

1. Identify the key resources and capabilities of Discovery.
2. Conduct an analysis to determine the value of the resources and capabilities. Which are most valuable, according to your analysis?
3. What evidence of dynamic capabilities can you identify from the case study?
4. How sustainable is the success of Discovery from an RBV perspective?

7.3.2.2 Functional analysis as a framework for identifying distinctive capabilities

Each organisation has certain principal functional areas according to which it operates. Typical functional areas that can be used in such an analysis include the following:

- Corporate management (corporate head office functions)
- Research and development
- Human resources (HR)
- Finance
- Marketing
- Customer care
- Sales
- Production or operations
- Logistics or supply chain management.

A functional division depends on a vertical cross-section of the organisation. For example, the marketing function is responsible for all aspects related to product development, promotional activities and advertising, pricing policies and distribution channel strategy, while the HR function is responsible for all aspects relating to recruiting, developing and retaining human resources. An organisation can use the functional division as a basis for identifying capabilities (see [Table 7.1](#) for examples of functional capabilities). The key question to consider is what distinctive capabilities the organisation has (if any) in each of the functional categories it considers.

While the functional framework provides a framework for analysis that can easily be understood and applied by most managers, it does not explicitly consider the value of cross-functional coordination, which might be a source of competitive advantage. In the Strategy in action case, for example, we can see that Discovery's success lies in its ability to coordinate innovation across the whole organisation, rather than in one specific functional area.

7.3.2.3 The value chain (Porter's value chain) as a framework for identifying capabilities

Porter's value chain is an expansion of the idea of the business system originally developed by McKinsey & Co. It describes the chain of activities in which an organisation engages to add value to a product. This chain ranges from

R&D to marketing and after-sales service. Porter identified two categories of activities in the value chain (see [Figure 7.3](#)):³³

- *Primary activities* that contribute directly to the transformation of inputs and the adding of value to the end product. For example, a car manufacturer will buy raw materials and components from its suppliers, assemble the vehicles, do quality control, and deliver them to dealerships to sell at a profit. Primary activities thus contribute directly to the profitability of the organisation.
- *Support activities* that do not directly add customer value. In the example of a car manufacturer, they will need to do (among other things) financial management, HR management and public relations that may be necessary for the organisation but do not contribute directly to its end product and profitability.

Table 7.1 Examples of functional analysis of capabilities

Functional area	Examples of distinctive capabilities
Corporate management	Bidvest is a South African-based conglomerate that manages more than 300 diverse businesses and 130 000 employees worldwide. The corporate philosophy of Bidvest is that 'entrepreneurship, incentivisation, decentralised management and communication are the keys. We turn ordinary companies into extraordinary performers, delivering strong and consistent shareholder returns in the process.' ³⁴
Research and development	From its roots in the production of synthetic fuel from coal, Sasol has developed into one of the leading producers of fuel and chemicals in the world, adding value to coal, oil and gas reserves to produce products for industrial and consumer use.
Marketing	South African retailer Shoprite's marketing efforts to rebrand Checkers, using, for example, celebrity chef Gordon Ramsay and South African celebrity Nataniël to sing the praises of Checkers' meat, have been very successful, contributing to Shoprite's being regarded as the most valuable retail brand in South Africa in 2016. ³⁵
Product design	Bell Equipment achieved a strong position in the global articulated dump truck (ADT) market with its proprietary technology developed over decades.
Operations	Namibia Breweries Ltd brew their beer brands such as Windhoek Lager and Tafel Lager according to the Reinheitsgebot, the German Purity Law dating from 1516. ³⁶
Logistics or supply chain management	Amalgamated Beverage Industries (ABI) , the soft-drink division of South African Breweries, is the leading bottler for Coca-Cola products in South Africa. They also have a distribution agreement with Appletiser. ABI serves a customer base of more than 106 000 retailers with more than 260 fast-moving stock units. ³⁷

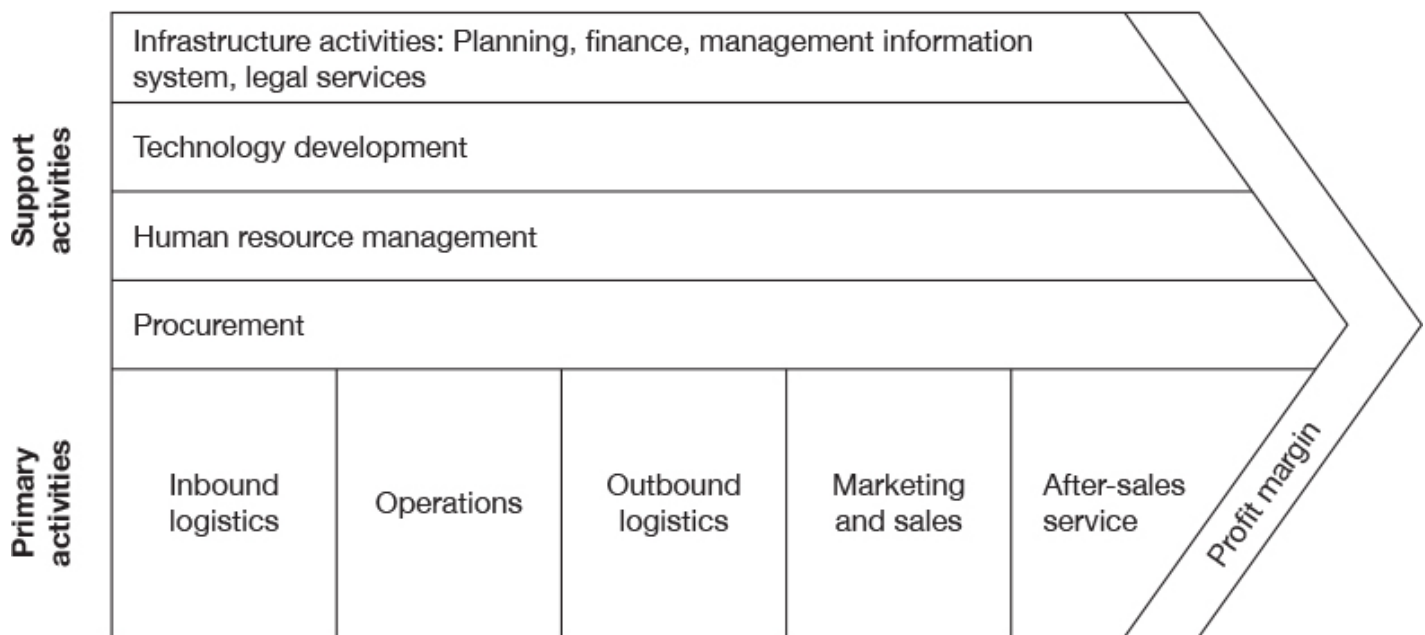
Although value chains may differ greatly in complexity and the number of activities involved, typical primary activities are described below³⁸ and in [Figure 7.3](#):

- *Inbound logistics* are those activities concerned with receiving, storing and distributing inputs to the product or service the organisation is going to produce.
- *Operations* are concerned with transforming the inputs to the final product or service. This may include activities such as manufacturing, assembly, quality control and packaging.
- *Outbound logistics* describe the processes relating to the collection, storage and distribution of the final product or service to customers. For products, outbound logistics may involve activities such as warehousing, materials

handling and distribution. For services, the activities may relate to bringing customers to a venue and delivering the service there, for example attracting customers into a movie theatre in time to view a screening.

- *Marketing and sales* provide the channel that makes customers aware of the product or service so that they purchase it. Advertising, sales activities and distribution channels are all examples of activities in the marketing and sales function.
- *After-sales service* includes installation, repair, training and spares. This channel maintains the value of the product or service.

Figure 7.3 The value chain³⁹



Typical support activities may include the following.⁴⁰

- *Procurement* is the process of acquiring the various resources required as inputs for primary activities.
- *Human resource management* is a critical activity that supports all functions. It involves those activities that recruit, manage, train, reward and develop people in the organisation.
- *Technology development* is concerned with developing and maintaining the know-how or other key technologies that are required for producing and delivering a product or service. This function is critical to the innovative capabilities of the organisation.
- *Infrastructure* provides the structures and routines of the organisation. For example, systems for planning, financial management, quality management, and even culture and leadership form part of the organisation's infrastructure.

Most organisations do not have strong capabilities throughout the whole value chain, but tend to perform better than competitors in one or two areas of the value chain.

7.3.2.4 Architecture, reputation and innovation

John Kay highlighted architecture, reputation and innovation as particularly important types of strategic capabilities.⁴¹ He suggested that relationships – with employees, suppliers, customers and other stakeholders – form the basis of distinctive capabilities. These relationships provide the organisation with three major ways in which it can distinguish itself from competitors:

- *Architecture*: This refers to the network of relationships and contracts both inside and outside the organisation. Long-term relationships can engender an ability to create knowledge and routines, and to respond to market changes. For example, South African company Bidvest manages more than 300 companies with 130 000 employees worldwide. Being able to manage this complex network of corporate functions and subsidiaries provides it with a competitive advantage that cannot easily be duplicated by competitors.
- *Reputation*: Some organisations have the ability to communicate favourable information about themselves to customers. This ability to enhance reputation is particularly beneficial in long-term relationships that take time to build, and is also difficult to imitate. For example, cellular operators Vodacom and MTN have become two of the most admired brands in South Africa due to their ability to create advertising and other marketing communications that resonate with South Africans and, in the case of MTN, Africans.
- *Innovation*: Some organisations base their success on innovation. Their ability to innovate builds on their structure, culture, innovation processes and rewards. For example, Sasol holds more than 500 patent families in the energy and chemicals industries. In the Strategy in action case, we can also see how Discovery's relentless focus on innovation has led to great success.

Most organisations have some of the components of the capabilities described above. However, few have managed to develop one or more of these capabilities into a real basis for competitive advantage.

The topic of knowledge and knowledge management has enjoyed much interest in management literature recently. The next section explores the relationship between knowledge and capabilities.

7.3.2.5 Knowledge and capabilities

Few topics in the field of management have enjoyed such growth in interest as the area of knowledge management and the importance of knowledge to the organisation. In the context of this chapter, we are not going to attempt a detailed discussion of the nature of knowledge. However, it is important to understand the role of knowledge as one of the key building blocks of organisational capabilities.

Organisational knowledge is described as 'the collective and shared experience accumulated through systems, routines and activities of sharing across the organisation'.⁴² In this regard it is important to understand that there are essentially two types of knowledge present in any organisation:⁴³

- *Knowing about*, or explicit knowledge, can be codified by writing it down or demonstrating it. This type of knowledge can therefore easily be transferred to others. For example, instructions on how to operate a machine used in production are easily transferred.
- *Knowing how*, or tacit knowledge, is expressed in its performance, for example playing a piano. However, because the underlying skills are tacit, they cannot be easily transferred or copied. Using the machine example again, it may be less easy to articulate the specific quirks of the machine known only to the operator.

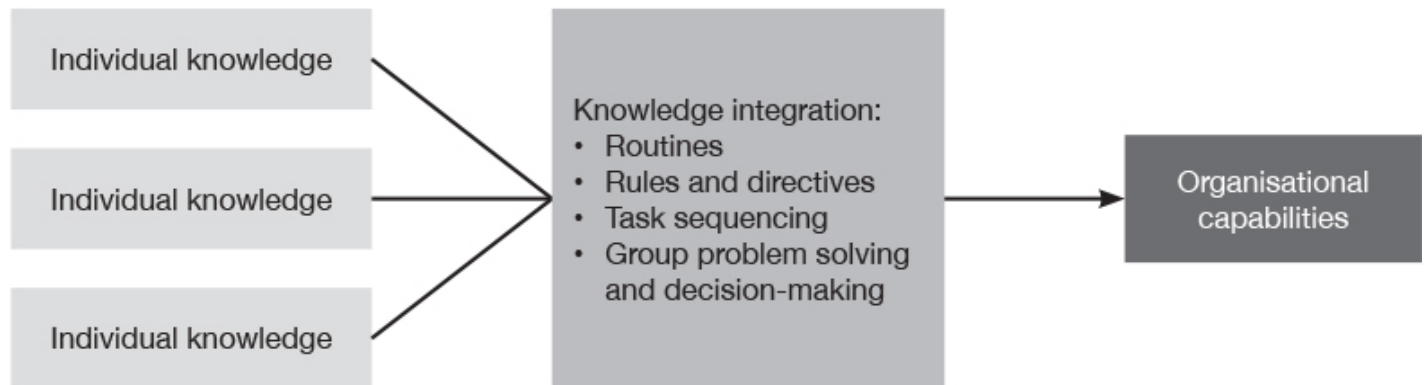
The concept of Ricardian rents (see [section 7.2](#)) suggests that tacit knowledge gained through years of experience forms the basis for competitive advantage since it cannot easily be copied by competitors.

One of the key challenges for an organisation is to integrate the specialist knowledge of individuals. One way of doing this is by means of **organisational routines** that form the building blocks of organisational capabilities.⁴⁴ This creates an organisational memory, and eliminates the need to reinvent a task every time it has to be performed. For example, in a McDonalds franchise, every worker knows exactly what to do to prepare the food, serve customers and perform other tasks without referring to a manual every time.

[Figure 7.4](#) summarises the role of knowledge as building blocks in the organisation. The knowledge of individuals is integrated by way of routines, rules and directives, task sequencing, and group problem solving and decision-making. Knowledge integrated in this way forms the basis for organisational capabilities. However, in new-to-the-world organisations (such as internet service providers or dotcoms when the internet became a commercial

prospect), learning often has to take place by trial and error since there are few individuals with specialist knowledge relevant to the business to help with knowledge integration.⁴⁵

Figure 7.4 Knowledge as building blocks of organisational capabilities

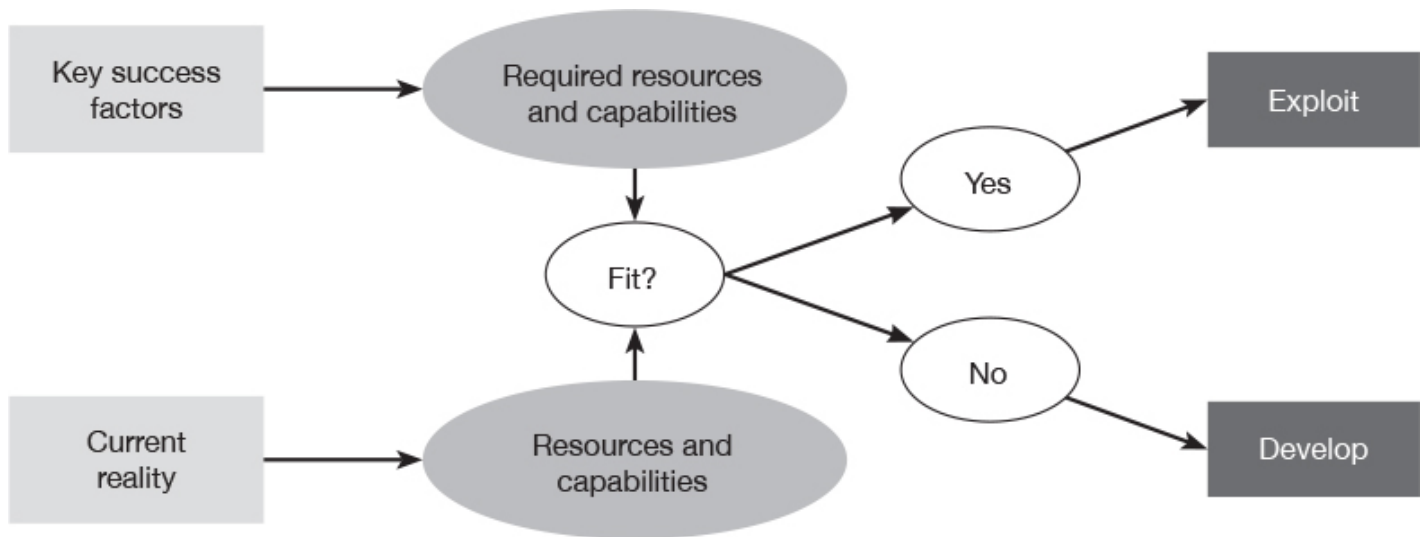


7.4 Internal analysis and industry key success factors

In [Chapter 6](#) *Analysing the industry environment* we examined the role of key success factors (KSFs) as external measures of success, determined mostly by what customers want and what competitive conditions dictate (see [section 6.2.2](#)). The value of resources and capabilities is enhanced if they have a good fit with 'strategic industry factors'.⁴⁶ Various authors have used the terms 'key success factors', 'critical success factors' and 'strategic industry factors' to describe external measures of success.

From [Chapter 6](#) we have seen that KSFs can play an important role in determining which capabilities to develop. The use of industry KSFs to determine which capabilities to focus on is depicted in [Figure 7.5](#). This suggests that organisations need to have a clear understanding of their current resources and capabilities, as well as those that they will need in the future. Understanding the gap between the current reality and future requirements provides important inputs in the strategic decision-making process. The organisation may need to build on existing resources and capabilities, for example by developing new products or markets (see [section 7.2.4](#)), or it may need to develop new ones (see [section 7.2.5](#)). As we have seen in the opening case, Sasol is already investing in alternative energy as a focus area for the future.

Figure 7.5 Using key success factors to identify capability gaps⁴⁷



7.5 Dynamic views of strategy

Various authors view dynamic capabilities (see [Figure 7.2](#)) as a higher order of resource.⁴⁸ The reason for this is that dynamic strategies strive to develop new distinctive capabilities rather than focusing only on what the organisation can do well now or could do well in the past. Ghemawat suggested that a pure resource-based view could create a focus on the past, and therefore proposed a dynamic view of strategy as a higher-order view of competitive advantage than the RBV.⁴⁹ This view rests on two principles:

- Distinctive capabilities can and must change over time.
- The volatility of the environment is a strong indicator of the need for and tempo of change required.

The concept of the capability life cycle (CLC) builds on the idea of dynamic capabilities. It suggests that capabilities, like industries and products, are subject to internal and external forces that cause them to evolve.⁵⁰ Three stages of capability evolution are suggested, namely:

- founding
- development
- maturity.

Capabilities may ultimately branch out into other capabilities, or 'die' and be replaced by other capabilities.

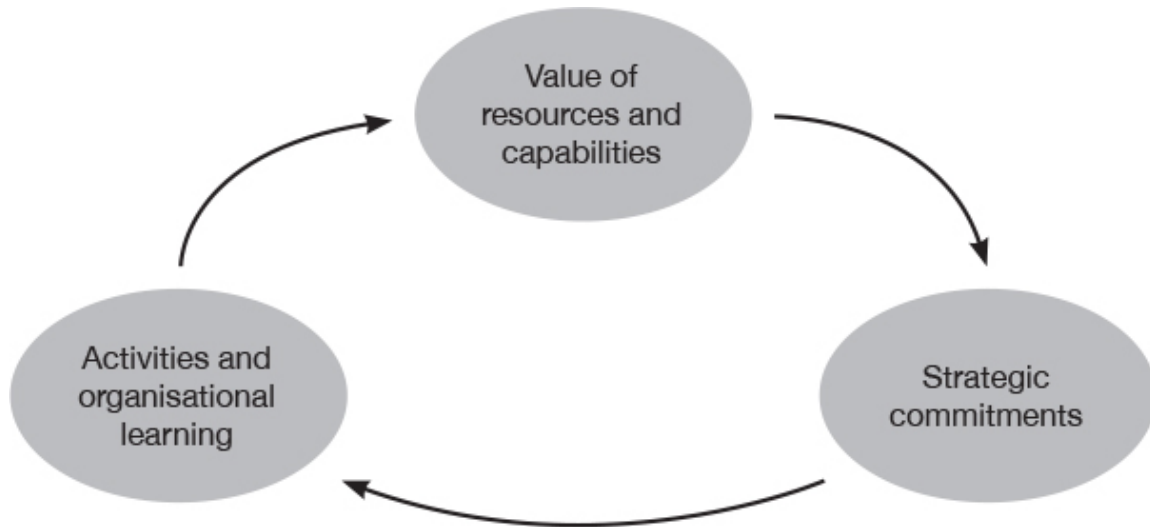
Ghemawat suggested that the dynamic approach attempts to link the organisation's past to its future, and in this way tries to answer three questions:⁵¹

- What did the organisation do well in the past?
- What can the organisation do well today?
- What must the organisation be able to do well in the future?

In [Figure 7.6](#), the current resource position (the value of resources and capabilities) provides the means for the organisation to make new strategic resource commitments. These commitments generate new resources to strengthen the current resource position. They also provide the organisation with the opportunity to learn new capabilities as it integrates new resource commitments and performs the activities required to make its investment successful.

Central to Ghemawat's concept of dynamic strategy is economic commitment theory and the notion of 'lumpy commitments'. These are strategic commitments that are extremely resource intensive and not easily reversed. They can cause substantial positive changes in the organisation's resource base if successful, but negative changes if not. From the perspective of dynamic capabilities, commitments form the basis for learning new organisational capabilities.

Figure 7.6 A dynamic view of strategy⁵²



There are two other concepts that Ghemawat associated with dynamic theories of strategy:

- *Lock-in* occurs when an organisation is locked into a strategic direction by virtue of a 'lumpy commitment', and cannot turn back or change course, for example when Disney bought the Star Wars franchise for \$4 billion.
- *Lock-out* occurs when a decision is delayed, and then cannot be implemented because the opportunity has passed. For example, when Vodacom decided not to go ahead with its plans to enter Nigeria as a mobile operator, this resulted in a situation where it was effectively locked out of the Nigerian mobile telephony market.

7.6 Identifying strengths and weaknesses

The previous sections dealt with the identification of resources and capabilities as a first step. However, as input into strategic decision-making, it is also important to identify the strengths and weaknesses of the organisation. Strengths are those resources and capabilities that provide an organisation with an advantage with regard to the competition, while weaknesses are those aspects where the organisation is at a disadvantage against the competition. The **value chain** provides a useful tool for identifying the organisation's relative strengths and weaknesses.

7.6.1 Value chain analysis

The value chain (see [section 7.3.2.3](#)) is a useful tool for identifying strengths and weaknesses, especially in two areas: cost analysis and differentiation analysis. In the area of cost analysis, the value chain can contribute as follows:⁵³

- Determining the relative importance of each activity with respect to total cost
- Identifying the cost drivers of each activity and how efficiently the organisation performs each one compared to competitors
- Understanding the influence of the cost of one activity on the cost of other activities (e.g. savings in one area may lead to increases in others)

- Identifying activities that can possibly be outsourced (e.g. where other organisations can perform the activities at a lower cost).

The process of using the value chain for cost and differentiation analysis for the purpose of identifying strengths and weaknesses can be outlined as follows:⁵⁴

- *Step 1:* Identify the component activities of the value chain – in other words, the primary and support activities that make up the organisation's value chain.
- *Step 2:* Establish the cost of each activity, and focus on those that are the most important contributors of cost. In the same way, identify the activities in the value chain that are the most important contributors to differentiation. In other words, which activities contribute most to customers' willingness to pay more for a product or service?
- *Step 3:* Compare costs and differentiation drivers per activity with competitors to establish competitive benchmarks.
- *Step 4:* Identify cost and differentiation drivers – in other words, those things that have the most impact on the cost of the activity or on the perception. Linkages are important as costs may be caused by the way in which certain other activities are performed. In the same way, differentiation may be influenced by the way in which certain other activities are performed. For example, performing a 100% quality check may be much more expensive than performing a quality check on a sample of 10% of production. However, the savings on customer returns and repairs, and the resultant increase in the perception of quality may more than make up for the additional cost. An organisation must therefore examine linkages carefully and ensure that it fully understands the implications of each decision to reduce costs or to increase differentiation.
- *Step 5:* Identify opportunities for reducing costs or for improving quality.

CASE EXAMPLE: Cost and differentiation advantages in the wine industry value chain

When analysing cost and differentiation advantages – in other words, competitive strengths – it is important to understand the drivers of uniqueness in each activity in the value chain. The organisation should identify the most promising areas on which to focus. In other words, the organisation must establish where it can achieve the greatest differentiation at the lowest possible cost.

It is also important to identify potential areas for profitably linking the organisation's value chain with that of customers. By allowing customers to 'create' or customise their own product, an organisation can create opportunities for increasing value and revenue at a low incremental cost. For example, a wine estate can offer customers the opportunity to have customised labels that replace the wine estate's name with their own.⁵⁵ This provides good value and additional income at a relatively low additional cost. [Figure 7.7](#) is a simplified value chain for a South African wine producer. It contains some examples of opportunities for cost reduction or differentiation. However, when using the value chain and other means of establishing competitive strengths and weaknesses, it is important to understand the role of benchmarking.

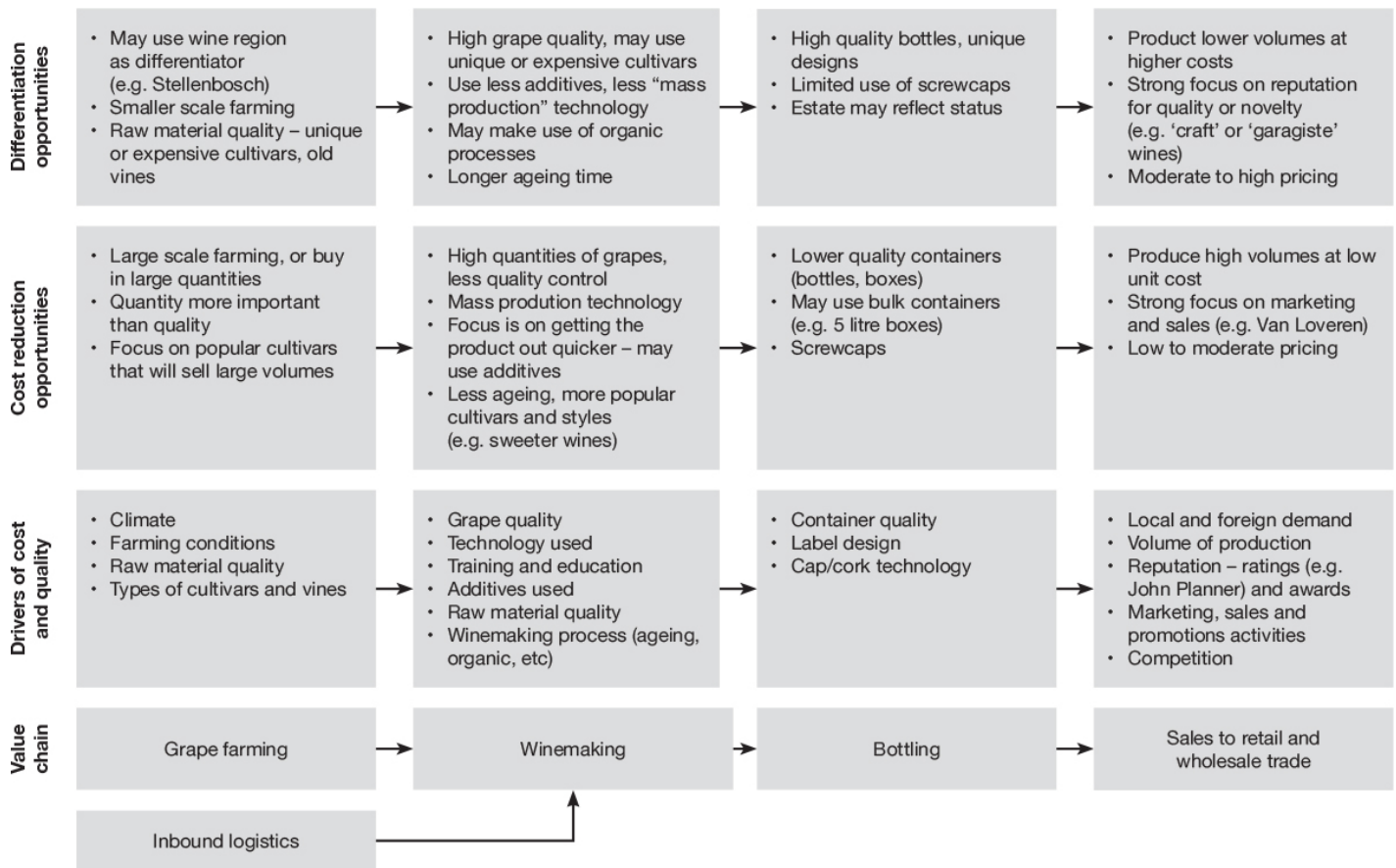
7.6.2 The role of benchmarking

All identification of strengths and weaknesses is relative. In other words, it depends on how well the organisation measures up to competitors or to its own performance in the past. The objective is to change behaviour and gain momentum for improvement and change. **Benchmarking** provides a tool for identifying relative strengths and weaknesses.

Johnson et al.⁵⁶ identified three types of benchmarks that organisations can use as a means of comparison:

- *Historical benchmarking* occurs when an organisation compares its performance to that of previous years. This is an indication of relative performance, and is generally used in, for example, financial reporting. The danger of relying purely on history is that it is an internal measure and does not account for any external changes.
- *Industry benchmarking* is used to compare the organisation's performance and processes across a number of performance indicators with the industry or other similar organisations. While this is a more useful comparison than using only historical data, the inherent danger is that the industry may be underperforming or using outdated practices.
- *Best-in-class benchmarking* may be used to seek comparisons more widely than just the industry. The idea is to compare the organisation's performance against the 'best in class'. This is also commonly referred to as 'best practice'. A common objective for comparing the organisation with best practice is to move beyond continuous improvement, and to achieve dramatic improvements in performance. For example, if the public sector wants to improve their quality of service dramatically, best-in-class benchmarking may help them to learn from other industries such as banking and telecommunications.

Figure 7.7 Cost and differentiation advantages in the wine industry value chain⁵⁷



Using the benchmarking process is not without danger. Johnson et al.⁵⁸ warns that it can lead to a preoccupation with the measure instead of the behaviour. This may be directly counter to the objective of the benchmarking exercise, which is to encourage strategic change. In addition, benchmarking will not reveal the underlying reasons for the difference in performance between organisations.

7.6.3 A practical framework for the appraisal of resources and capabilities

There are several different approaches to identifying an organisation’s strengths and weaknesses in practice. Grant⁵⁹ proposed one of the most practical and easy-to-use ones. The process is illustrated with a real but disguised example from a medium-sized industrial manufacturer producing safety materials for the industrial market. Let us call the organisation CSM for the purposes of the illustration.

Step 1: Identify key resources and capabilities

Grant suggested that the first step in the process can be performed using both demand side and supply side approaches. The supply side (organisational) approaches of functional analysis and value chain analysis are useful tools for identifying possible key resources and capabilities. For demand side analysis, the organisation can use key success factors and the resources and capabilities they imply. For example, Capitec Bank has been very successful using innovative means of cutting costs in the value chain, for example by moving towards paperless banking. At the same time, they focus on their target markets with simplicity and affordability – two key success factors when dealing with lower-income customers. See [Table 7.2](#) for a list of resources and capabilities identified for CSM.

Step 2: Appraisal of resources and capabilities

Once the organisation has identified its resources and capabilities, it should appraise them using two criteria:

- *Strategic importance* can be assessed using key success factors and customer decision criteria as guidelines. When appraising resources and capabilities in terms of their strategic importance, the organisation should appraise them individually on their importance for long-term survival and prosperity. They are typically rated on a scale of 1 to 10, where 10 means that the resource or capability is of critical importance, while 1 suggests that it is not at all important for the long-term survival of the organisation.
- *Relative strength* is used to appraise resources and capabilities relative to competitors. While objective appraisal of the relative strength of a resource or capability is often tricky as managers find it difficult to be objective about their own organisations, benchmarking can help to provide an objective view of relative performance. Once again, a scale of 1 to 10 can be used, where a score of 10 implies that the organisation is far superior to its competition, while a score of 1 implies a far inferior performance.

See [Table 7.2](#) for an illustration of CSM’s rating on the two criteria.

The next step in the process is to identify the key strengths and weaknesses by combining the two ratings for each of the resources and capabilities in a grid display (see [Figure 7.8](#)).

Step 3: Developing strategy implications

The visual depiction of strengths and weaknesses provides a strong message about the future strategic direction of the organisation.

Key strengths are those resources and capabilities that are critical to the future success of the organisation. They should therefore be nurtured and used as a basis for building and extending competitive advantage. In our example, CSM’s production facility (R2) is substantially better than that of the competition. However, given our knowledge of resources and capabilities, capabilities are generally more sustainable sources of competitive advantage. Therefore, CSM’s relative strength in technology research and development (C2) could be further enhanced and used as a means of overcoming their weakness in product innovation and development (C1).

Table 7.2 Appraisal of CSM's resources and capabilities

Resources/Capabilities	Strategic importance	Relative strength	Comments

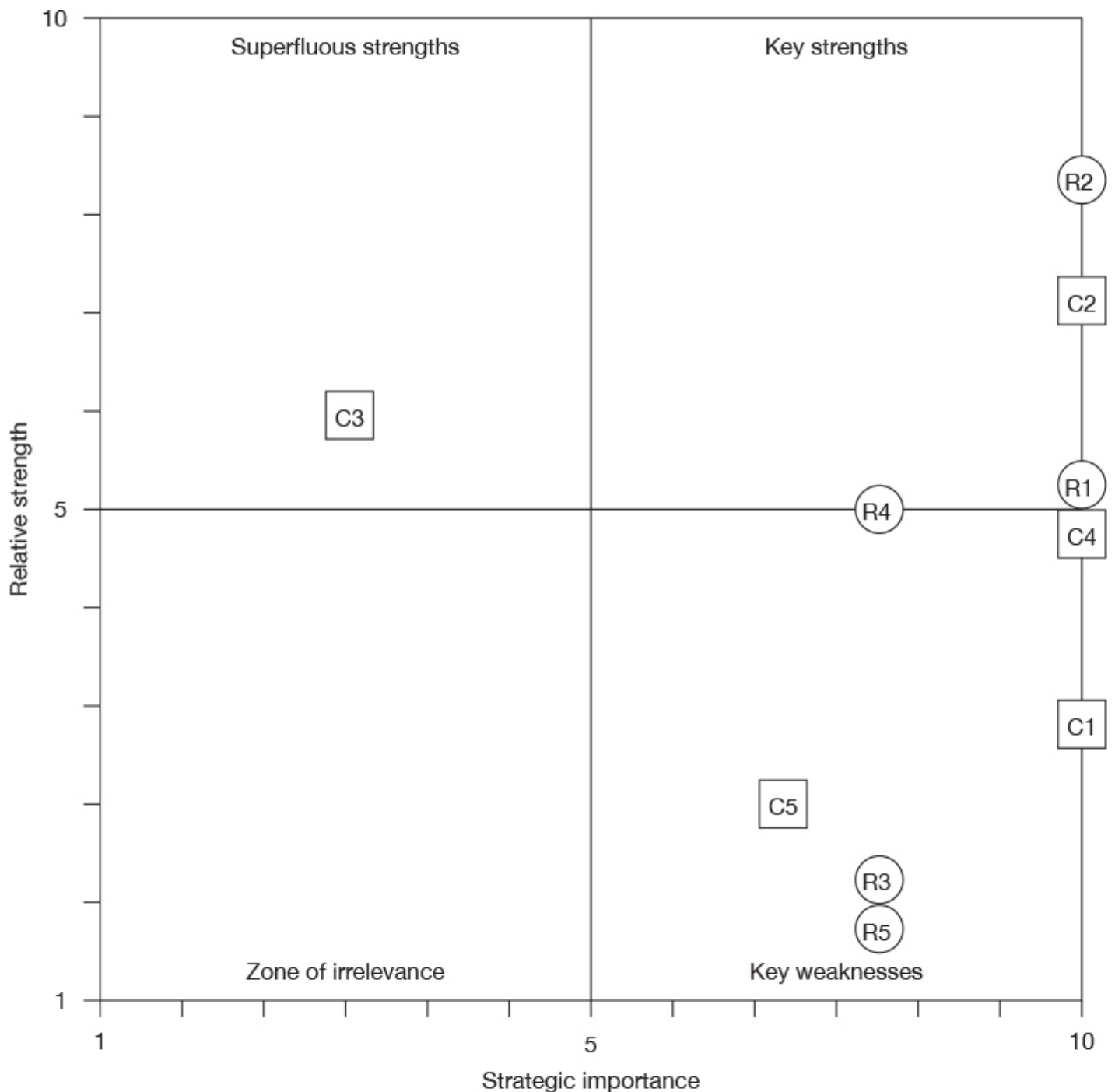
Resources/Capabilities	Strategic importance	Relative strength	Comments
Reputation (R1)	10	5	Good reputation in some regions, unknown in others
Own production facility (R2)	10	8	Owens a good production facility
Exclusivity agreements with key suppliers (R3)	8	1	Only one exclusivity agreement in place
Strong brands (R4)	8	5	One or two strong brands
Strategic alliances (R5)	8	1	Little progress in establishing strategic alliances
Product innovation (C1)	10	3	Innovative in only one product line
Research and development (C2)	10	7	Little product innovation, but has a strong R&D team
Industry value chain (C3)	3	6	Has relatively strong influence over the industry value chain, with some downstream and upstream activities
Sales and key account management (C4)	10	5	Limited staff, limited activity
International market development (C5)	7	2	Some exports, but generally little international marketing activity

Note: *R denotes resources and C denotes capabilities.*

Key weaknesses are areas that are critical for future success, but where the organisation underperforms when compared with its competition. This therefore provides clues to identify the resources and capabilities that need to be addressed. In the case of CSM, its lack of exclusivity agreements with key raw material suppliers (R3) and its relative weakness in product innovation (C1) make it vulnerable to competition. The organisation should develop strategies to overcome these weaknesses.

CSM has one superfluous strength in the form of its integration of the industry value chain (C3). How should superfluous strengths be handled? On the one hand, the organisation could decide to de-emphasise it and focus resources on key strengths and weaknesses. On the other hand, if ways could be found to make a virtue or differentiating aspect of it, the organisation could leverage this to its advantage.

Figure 7.8 Appraising CSM's resources and capabilities – a visual summary



7.7 Summary

The crux of internal analysis is the understanding of the strategic value of resources and capabilities, and their role in establishing competitive advantage. Many organisations do not seem to have a clear picture of their own or their competitors' resources and capabilities. This is particularly important as recent developments in strategic thinking suggest that distinctive capabilities form a more lasting basis for strategic success than simply striving for a strong position in the industry.

Various frameworks are useful for identifying distinctive resources and capabilities. In this chapter, we explored a functional framework and the value chain as useful frameworks for identifying distinctive resources and capabilities.

We also explored the roles of architecture, reputation, innovation, and knowledge as key drivers of capabilities.

The concept of dynamic capabilities emerged as a critical topic. This concept implies that organisations cannot rely on their past and present capabilities for success, but constantly need to develop new capabilities as sources of competitive advantage.

When developing strategies based on distinctive resources and capabilities, the key challenge is to identify strengths and weaknesses relative to the competition. In this regard benchmarking is a useful tool, and a practical framework for identifying strengths and weaknesses was also illustrated.

For managers, the implications are that internal analysis is not a periodic or once-off event. An ongoing understanding of the distinctive resources and capabilities of the organisation is required, and the implications for strategic direction. One of the key problems in this regard is the objectivity of managers, who often find it difficult to provide objective appraisals of the organisation's resources and capabilities. This suggests that the use of benchmarking and other practical frameworks can provide a more objective means of identifying relative performance of resources and capabilities.

Once an organisation has identified its strengths and weaknesses, it must focus on identifying strategic initiatives to build on its strengths and to mitigate its weaknesses. If this is not done as part of a constant process of building capabilities and developing new ones, a deterioration in capabilities may result, accompanied by a decline in competitive advantage.

REFLECTION BOX:

One of the key tenets of the resource-based viewpoint is that 'history matters', yet many management gurus say that organisations should constantly 'destroy' and 'reinvent' themselves. What are the implications of 'destroying and reinventing' a company from an RBV perspective?

Opening case study questions

1. What are the key reasons for Sasol's success from a resource-based perspective?
2. How sustainable do you think Sasol's success is?

Discussion questions

1. Differentiate between resources and capabilities, and explain the relationship between them.
2. Assess the importance of a strong brand for an organisation from a resource-based perspective.
3. In the Opening case study we saw that Sasol is building a capability in the alternative energy industry, because they believe that this should be part of their future capabilities. What options do they have for developing this capability?
4. Compare and contrast the four methods for identifying resources and capabilities discussed in this chapter.
5. Compare and contrast threshold, distinctive and dynamic capabilities, and give an example of each.
6. Explain the importance of knowledge in establishing competitive advantage.
7. Explain three ways in which you would go about identifying strengths and weaknesses for an organisation.

Using knowledge and skills

1. Select an organisation with which you are familiar. Develop a value chain for it, and identify opportunities for obtaining cost and differentiation advantages.

- Use the same organisation identified in the previous question. Use the methodology developed by Grant⁶⁰ (see section 7.6.3) to identify key strengths and weaknesses.
3. Conduct a quick survey of three to four managers in any organisation to establish:
 - a) whether they conduct internal analysis
 - b) if they do, how they do it
 - c) whether they can name what they believe are their organisation's distinctive capabilities.

Further reading

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Suggested websites

- 1000 Ventures – A website with various references to the resource-based view
(http://www.1000ventures.com/business_guide/mgmt_statagic_resource-based.html).
- The Value Chain – A lecture on using the VC to identify resources and capabilities
(<https://www.coursera.org/lecture/uva-darden-foundations-business-strategy/value-chain-KEUPJ>).
- Southern African Institute for International Affairs (<http://www.saiia.org.za/value-chains-in-southern-africa>).
- A video with Robert Grant and J-C Spender discussing the knowledge-based view of the firm
(<https://www.youtube.com/watch?v=KiWvlo-ZtXM>).

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PART THREE

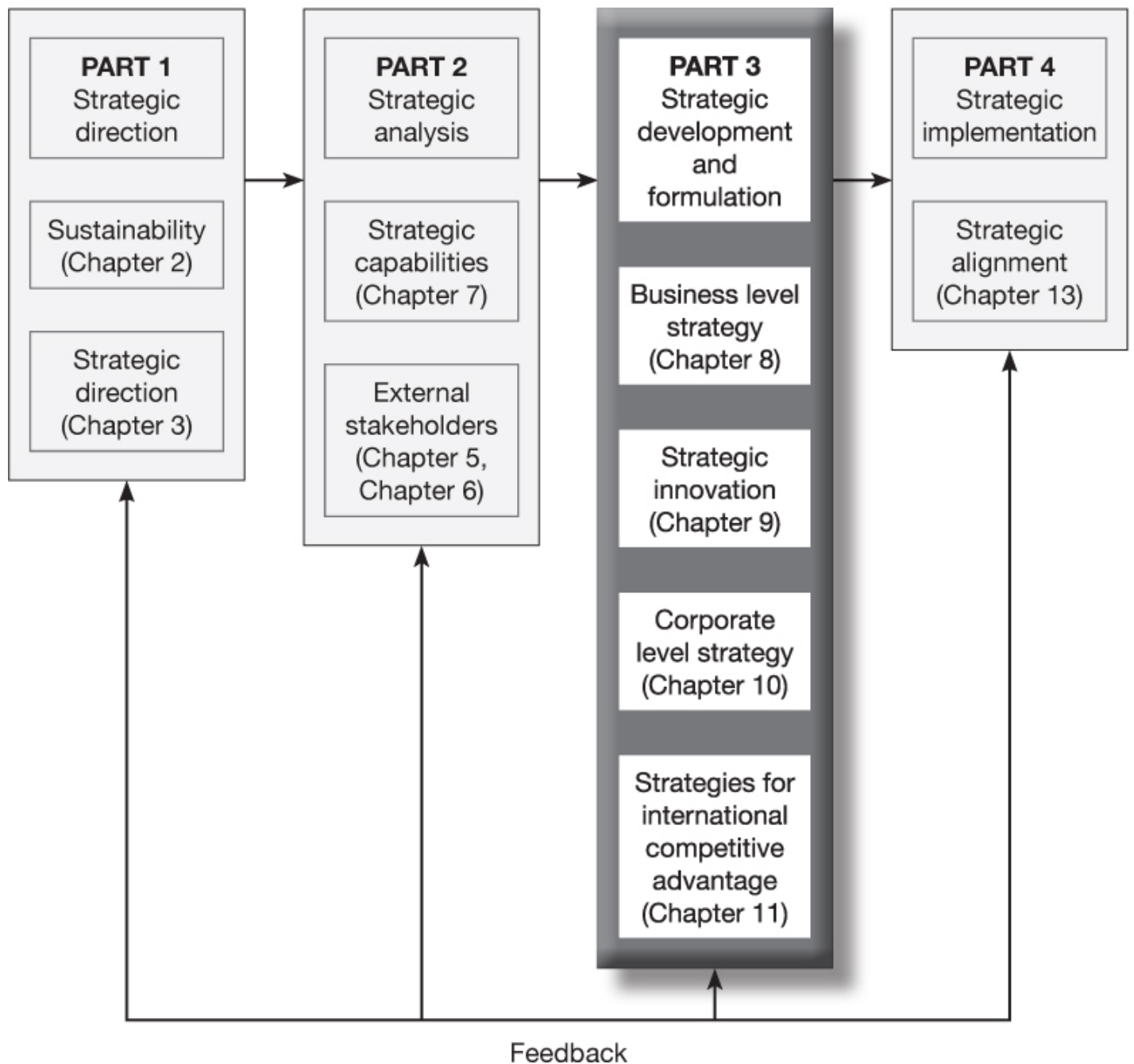
**Strategic development and
formulation**

THE ORGANISATION'S STRATEGIC CONTEXT

Strategic
decision-
making
(Chapter 4)

Strategic
leadership
(Chapter 12)

Strategic risk
management
(Chapter 14)



CHAPTER 8

Business level strategy

Annemarie Davis

LEARNING OUTCOMES

After reading this chapter, you should be able to:

- explain what business level strategy is
- comment on the strategic management process and when business level strategies are crafted
- distinguish between the different types of business level strategy
- discuss the criteria to consider when evaluating business level strategies
- identify and discuss the business level strategies in an organisation
- critically evaluate the business level strategies in an organisation from a strategic fit perspective.

KEY TERMS

business level strategy (also referred to as competitive strategy)

corporate level strategies

cost leadership strategy (also referred to as low cost provider strategy)

differentiation strategy

focus strategy

low-cost focus

operational strategy (also referred to as functional strategy)

sustainable competitive advantage

strategic direction

OPENING CASE STUDY



Competing in South Africa's airline industry – only the fittest survive

Collapsing airlines, rising fuel prices, economic recessions, increased airport and landing charges, robust competition among low-cost airlines, price sensitivity in the market – these are all challenges that operators in the airline industry face. The International Air Transport Association (IATA) predicted that aviation on the African continent would make zero profits in 2012 (Summit TV, 2012¹). The South African airline industry has experienced changes that have shaped the face of airline travel substantially. In the last eight years since 2010,

the industry saw the collapse of Velvet Airlines and 1time as well as the grounding of SA Express's 29 planes due to poor maintenance of aircraft.² In terms of new entrants to the market since 2015, the industry saw the introduction of FlySafair and CemAir. The national carrier, South African Airways (SAA) hit another low when role players called for it to be placed under business rescue with a clear undertaking that the airline would be privatised.³ By 2018, SAA had had an operating loss for six consecutive years.⁴ As part of its turnaround strategy, the financially embattled airline commenced discussions in search of aviation industry investors to help it return to profit and avoid further government bailouts.⁵

Despite being knocked by a sluggish travel market, airlines need to take stock of their business models and strategies. It is against this backdrop that the strategic management teams at the airline operators in South Africa need to develop their competitive strategies to sustain their operations and ensure wealth for their stakeholders.

The airline operators serving South Africa are grouped according to full-service airlines and low-cost airlines.

Full-service airlines

Full-service airlines provide a range of facilities to make the journey comfortable and stress free. In full-service flights, meals and travel insurance are included, and provision is made for different seating classes.

South Africa's full-service airlines

South African Airways

SAA is the national flag carrier and the largest airline in South Africa. Founded in 1934,⁶ the airline was initially overseen and controlled by South African Railways and Harbours. In 2006, SAA split from its parent company and now operates as an independent airline. SAA is considered one of the leading carriers in Africa and offers the biggest route network in Africa and flies to more destinations, both overseas and within South Africa, than anyone else.⁷ SAA made it onto the list of the World's Top 100 Airlines and is ranked at number 45 globally.

Regionally, it was voted the Second Best Airline in Africa.⁸ SAA offers economy, business and first-class cabins. SAA envisions a future of being Africa's leading world-class airline through offering commercially sustainable world-class air passenger and aviation services in South Africa and the African continent to its tourism and trading partners.⁹

As a full-service airline, SAA caters for leisure as well as business travellers. Within the South African domestic market, the competitive conditions called for trading down to low-cost carriers. Despite launching its own such carrier subsidiary Mango in 2006, SAA still has a disproportionate percentage of its premium capacity allocated to the increasingly price-sensitive domestic market.¹⁰

South African Express Airways

SA Express Airways started operating in 1994 and is one of the fastest-growing regional airlines in Africa. It is a wholly owned subsidiary of the Department of Public Enterprise.¹¹ SA Express caters for business and leisure travellers offering flights in economy, business and first class, aimed at a range of 12 South African and regional destinations in Namibia, Botswana and the DRC. The SA Express philosophy is to combine safety and comfort with the convenience and time savings of direct regional routes.¹² Since taking to the skies in 1994, SA Express has differentiated itself by offering seamless connectivity between small cities and major economic hubs.¹³ The differentiated services offered by SA Express is built on coordinated flight schedules and alliances with SAA Alliance airlines to provide hassle-free services in areas such as ticketing, check-in facilities, mutual branding and shared flight codes, as well as rewarding customers with Voyager benefits. Their fleet of aircraft offers high levels of services with leather seating and superior design.¹⁴

During May 2018, SA Express experienced major challenges which led to the grounding of 29 aircrafts, which was due to its deficient safety management system. Since the suspension, SA Express underwent a stringent and rigorous process to meet the safety standards.¹⁵ Towards the end of July 2018, the Civil Aviation Authority

lifted the suspension and allowed two SA Express aircraft to continue operations while the others are still up for inspection.¹⁶

Airlink

Airlink is a privately owned carrier and has a passenger profile of 40% leisure and 60% business.¹⁷ It is the largest independent regional airline in southern Africa, linking more customers to the smaller towns, cities and regional centres than any other local airline.

Airlink is a regional feeder airline.¹⁸ Airlink is a regional feeder airline¹⁹ that flies to smaller towns, cities and regional centres in southern Africa and offers flights in economy, business and first class. The airline is known for its strategic alliance with SAA and SA Express, which led to the establishment of the aviation network in Africa.

SA Airlink won the St Helena government contract to run a weekly flight service to St Helena because it has jets small enough to properly use the runway where the wind shear makes it impractical for anything bigger than the 98-seater Embraer E190 jet,²⁰ and in October 2017 celebrated its first flight there. Based on increased demand during 2018, SA Airlink introduced new aircraft to service the Cape Town–Victoria Falls route, where it offers increased capacity as well as business class travel.²¹ Using its resources to exploit opportunities in the industry contributed to its competitive advantage and strengthened Airlink's position in the South African aviation industry.

Comair Limited – British Airways

Comair Limited began its operation as Commercial Air Services in 1945 with flights between Rand Airport in Germiston and Durban International Airport. Comair entered domestic operations in 1992, targeting leisure passengers. Later, Comair Limited became a franchise partner with British Airways.²² Under the Comair umbrella are a number of airline and travel-related brands including Kulula.com, British Airways, SLOW, Comair Travel, Comair Training Centre and Food Directions.²³

In 1996, Comair joined British Airways as a franchise partner and became known as British Airways Comair, taking on the colours and livery of British Airways International. The British Airways brand brought with it a rich heritage of stylish travel, reputation for service excellence and a wide range of products such as the prestigious Executive Club frequent flyer programme. As a franchise partner of British Airways and a member of the oneworld® alliance, Comair offers seamless connections to the international route network, and continues to serve local premium customers with the same standards in mind.²⁴ British Airways is a premium, full-service airline operating domestic routes in South Africa, offering flights in economy, premier economy, business and first class. Comair tells the story of a successful airline with an unbroken record of profit for the company since its inception 71 years ago. The company continues to benefit from its fleet renewal programme, which enables it to operate more competitively than airlines operating older, less fuel-efficient aircraft.²⁵

CemAir

CemAir is a privately owned air carrier with experience in operating and supporting aircraft with an emphasis on maintaining First World standards in Third World environments.²⁶ CemAir offers flights to smaller destinations in South Africa targeting airports not regularly serviced by other operators and offers only one class of travel. CemAir has experience in operating and supporting its own aircraft in a variety of conditions. The company strives to achieve high levels of reliability through the application of constantly evolving internationally recognised standards. It has operating and leasing experience throughout Africa and the Middle East, including Afghanistan, Tunisia, Libya, Sudan, South Sudan, Nigeria, the DRC, Kenya, Mali, Gabon, Ghana, Tanzania, Namibia, Botswana, Mozambique, Madagascar and South Africa.²⁷

CemAir has also faced turbulent times in the South African aviation industry. During February 2018, 12 planes operated by CemAir were grounded due to a documentation issues identified by the Civil Aviation Authority in the annual audit of the CemAir aircraft maintenance organisation. The suspension was lifted later in

the month and CemAir jumped at the opportunity in May 2018 to step into the shoes of the grounded SA Express domestic link between Johannesburg and Richards Bay. As part of its growth strategy, in November 2017 CemAir ordered two Q400 Bombardier Turboprops and signed a lease agreement for a used Q400. According to the CEO of CemAir, the airline enjoyed significant growth based on its focused approach to selecting the right aircraft for its operations. Through the procurement of the new aircraft, CemAir plans to expand their scheduled operations beyond South Africa and continues to support new opportunities across the continent. With these Q400 aircraft, CemAir will increase its current fleet of Bombardier aircraft to 17 – including five Q Series turboprops and 12 CRJ Series aircraft. CemAir recently added a used CRJ900 aircraft to its fleet, the first in South Africa.²⁸

Low-cost airlines

Low-cost airlines (also known as no-frills, discount or budget airlines) generally offer lower fares and fewer comforts with a single passenger seating class. Prepacked foods and snacks are available on board for travellers to purchase. In many cases, travel insurance is charged separately and at the discretion of the traveller, whereas with full-service airlines, this is part of the offering and included in the ticket price.

Comair Limited – Kulula.com

Comair Limited introduced their low-cost carrier, Kulula.com, in 2001. Since taking off, Kulula.com has been on a tremendous growth drive, offering, through its partnerships, travel additions to its customers, such as car hire, accommodation and holiday packages. The Kulula.com brand is associated with humorous marketing campaigns and providing best value to customers. Kulula.com offers low-cost, single-class flights.

Mango

Mango started operating as a low-cost airline towards the end of 2006, targeting the price-sensitive market. It is a no-frills airline carrier operated by SAA and offers competitively priced, single-class flights. Mango's mandate is to make air travel accessible and affordable.²⁹

FlySafair

FlySafair began operations in October 2014 and is considered a specialist aviation organisation offering a wide range of specialist airlift services. FlySafair responded to the opportunity to open the skies to many who had never flown before. They offer great fares and a reliable on-time service. During 2017, FlySafair was again named the most on-time airline in the world by air travel intelligence specialist OAG.³⁰ When FlySafair launched its maiden flight on 16 October 2014, their low fares disrupted the market, bringing down the average cost of flying by as much as 32% on some of the routes it operates.³¹ FlySafair offers a range of options to their customers – from a seat and limited carry-on luggage for the lowest possible fare to additional perks to allow customers to customise their travel experiences to meet their needs and budget.³²

Fastjet

Fastjet focuses on air travel throughout East and southern Africa. Fastjet followed easyJet's business model and it was launched in 2012. It offers low-cost travel solutions for all people, which resulted in a loyal customer base of which 80% are repeat flyers.³³ Their philosophy is simple: the lowest possible fares with options to choose pay-as-you-go travel extras such as check-in luggage and assigned seating.

The future of South Africa's low-cost airline industry

With the demise of 1time airlines, the grounding of aircraft, liquidity challenges and turmoil in the global low-cost airline industry, the sustainability of local low-cost airlines is questioned. When asked what is needed for future sustainability, Comair CEO Erik Venter explained that airlines need to make massive investments in planes to stay in business. These investments require airlines to get more revenue per flight and the only way to do so is

to fly bigger and more efficient airplanes. He also explained that the demand in the low-cost airlines is price sensitive at the lower end of the market.³⁴

To expound the challenge in the South African low-cost airline industry is the threat of new competitors entering African skies. During June 2012, easyJet founder Stelios Haji-Ioannou indicated his backing of a new budget airline, dubbed Fastjet, to take to the African skies, promising to bring low-cost flights to millions of people on the continent.³⁵ In the South African budget airline industry, Mango added two new routes after the demise of former rival low-cost airline 1time. Mango communications manager Hein Kaiser confirmed that those additional routes have always been on their radar, and implementation of the plan was brought forward³⁶ with the collapse of 1time. During February 2018, the Competition Commission prohibited the proposed merger between SA Airlink and Safair Operations as the transaction was likely to result in a substantial prevention of competition.³⁷

Another complication to the industry is the number of management changes and appointments. Mango is operating under an acting CEO Nic Vlok. Former Mango CEO Nico Bezuidenhout is now with Fastjet, and SAA welcomed a new CEO in November 2017. Management and leadership changes further exacerbate the complexities of the airline industry.

Mango's competitive strategies

Mango's CEO Nic Vlok confirmed that Mango scheduled more flights as the number of SAA's domestic flights reduced in 2018. Nic Vlok also confirmed that 'Mango remains committed to service excellence and our brand values of innovation, operational efficiency and excellence in customer service'.³⁸ The former CEO Nico Bezuidenhout explained during his tenure that Mango is able to survive even the worst market conditions as it has lowered its fuel consumption. Mango operates the most fuel-efficient fleet in the domestic skies and in some instances burns up to 25% less fuel than aircraft a couple of decades older. 'Significant savings are realised in this manner alone, given that fuel could represent up to 35% of an airline's operational cost'.³⁹ Mango's success is ascribed to its low-cost structure and efficient operations. Mango's asset use is 25% higher than its competitors, and its productivity – the number of passengers carried per employee – is almost double. In the first year of Mango's operation, their four aircraft carried 1.6 million passengers, whereas 1time's 12 aircraft carried just under 2 million.⁴⁰

Only time will tell which airline operators are fit enough to survive.

Overview

In any strategic management process, the choice of business level strategy forms an integral part of strategic decision-making. In essence, the strategy formalises the route that the organisation will take to reach its end destination. When strategic decision-makers decide on a business level strategy, or a combination of these strategies, they have to consider the various factors that affect this choice. These factors include the organisation's overall strategic direction, strengths and weaknesses, its capabilities, opportunities and competitive forces in the industry. Once the strategic decision-makers have selected potential strategies, they need to evaluate these options to choose the most appropriate strategy or combination of strategies. This assists them to make the correct choices that will ensure sustainability and survival in the long term.

8.1 Introduction

Business level strategies deal with an organisation's plans to compete successfully. They are often referred to as competitive strategies because they relate to the organisation's deliberate decisions on how to meet its customers' needs, how to counter the competitive efforts of its rivals, how to cope with the existing market conditions, and how to sustain or build its competitive advantage.

As can be seen from the Opening case study *Competing in South Africa's airline industry*, organisations are faced with many challenges, specifically in the competitive market environment. The Opening case study describes the competitive challenges for full-service airlines as well as those of the low-cost airlines. Ultimately, survival and growth for the competitors in the airline industry require strategic decisions that match the organisation's strengths with the opportunities in the environment. The challenges in the South African low-cost airline industry include the declining economy, increasing fuel costs, increasing landing and airport charges, and leadership challenges with changes to management structures. Existing competitors in the industry are competing for market share while possible new competitors consider entering the industry despite these challenges. Intentions between airlines to merge further complicate the competitive environment. The Opening case study showed how the demise of one competitor enables another to take advantage of it and take on new destinations and routes. Winning in the marketplace is, in most cases, a result of the actions an organisation takes to seek and secure a **sustainable competitive advantage**. An organisation has a competitive advantage whenever it has an edge over its rivals in attracting buyers and coping with competitive forces. The Opening case study *Competing in South Africa's airline industry* showed that competition in the airline industry is rife. Full-service airlines like SAA and British Airways are competing for market share in the business travel segment, and Mango competes against [Kulula.com](#) and FlySafair for the price-sensitive segment.

It is therefore vitally important that the strategic decision-makers of the airline operators choose the most appropriate strategies to ensure that their competitiveness in the industry remains in line with their strategic intent. In the process of choosing their business level strategies, strategic decision-makers can use a range of criteria to evaluate the appropriateness of the various strategic options. This chapter also includes a section that describes the criteria for evaluating strategies – not only business level strategies, but also corporate level ones.

Before discussing the theoretical principles of business level strategy, it is necessary to link strategic choice with the theoretical principles already covered. The process of strategic management was explained with the use of a framework in [Chapter 1 section 1.6](#). This framework indicated that the strategic intent, stakeholders, and the variables in the internal and external environment affect the choice of strategies ([Chapters 4, 5, 6 and 7](#)).

[Chapter 2](#) linked strategic management with a focus on sustainability to ensure the long-term survival of the organisation. This chapter also discussed the strategic management process in terms of business ethics and corporate governance with specific reference to the role of stakeholders.

We then analysed the environments in which any organisation operates. [Chapters 5 and 6](#) considered the external environment. Because organisations operate in a changing environment, and an interdependent relationship between the organisation and its environment exists, an organisation needs to conduct a detailed analysis of the threats and opportunities, and its strengths and weaknesses ([Chapter 7](#)). **Strategies** are courses of deliberate action that strategic decision-makers take to match the organisation's unique strengths and capabilities with the opportunities in the external environment.

This chapter deals with the various strategic choices at the business level and how to evaluate them, followed by [Chapter 9](#), which addresses strategic innovation. Business level strategies are also referred to as competitive strategies and are commonly associated with leading strategy scholar and professor at Harvard Business School, Michael Porter. [Chapter 10](#) discusses corporate level strategies, while [Chapter 11](#) covers strategies for global competitive advantage (i.e. international strategy). The strategies to compete internationally form an important component of business strategies.

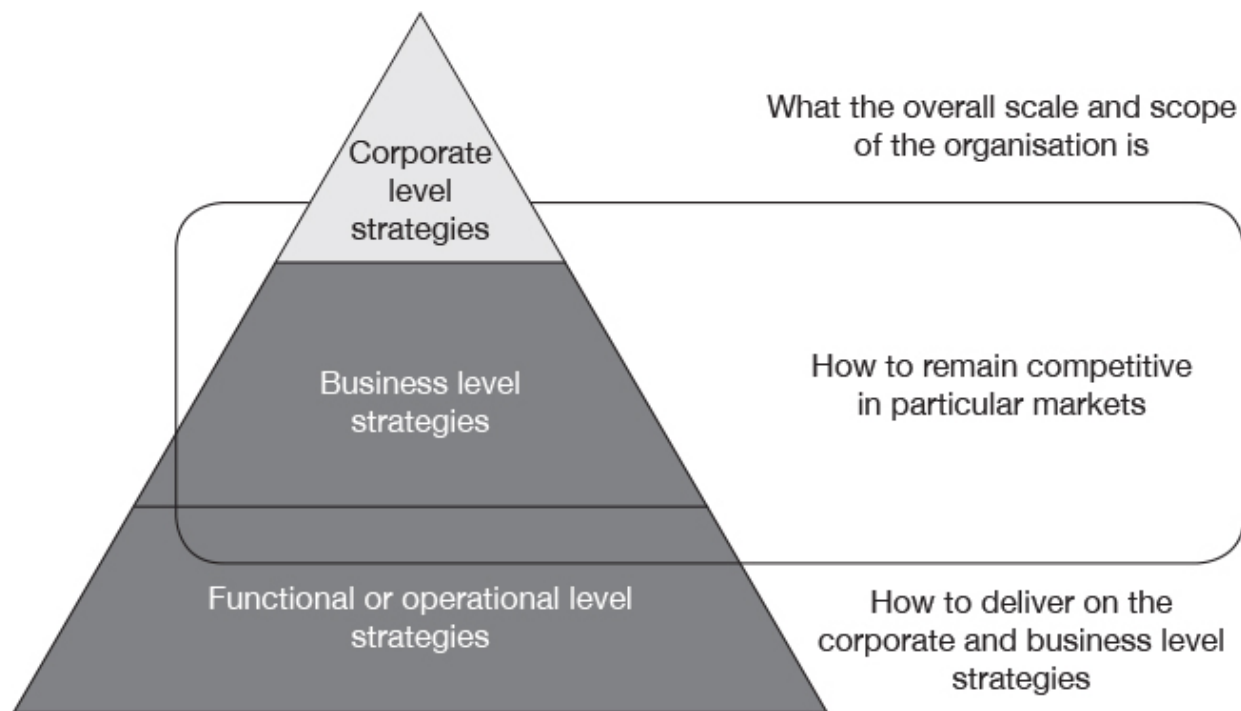
8.2 Levels of strategies

Strategic decisions are made at three levels (also see [section 1.3.2](#)). [Figure 8.1](#) depicts the three levels of strategies, each of which has a different focus. Different parties in the organisation are involved in the development of the three different levels of strategies, which are as follows:

- **Corporate level strategy** is concerned with the overall scale and scope of the organisation. It deals with the purpose of the organisation. [Chapter 10](#) discusses corporate level strategies.
- **Business level strategy** is also referred to as competitive strategy, and describes how to compete successfully in particular markets. Business level strategies deal with the products and services that an organisation needs to develop and position in the market to achieve competitive advantage and long-term survival. The Opening case study described South Africa's airline industry and the competitors. It also described the plans by Mango's executives to remain competitive – they follow business level strategies that are based on a low-cost base. Specifically, Mango builds its competitive advantage on a combination of business level strategies that aim to offer value for money to customers through a low-cost structure and efficient operations with an above-average use of their assets. This chapter focuses on business level, or competitive, strategies. Some authors refer to business strategies as 'battle plans'.
- The third level of strategy is **functional** or **operational strategy**. For the most part, this is concerned with how the component parts of an organisation deliver the corporate and business level strategies. Operational strategies are also referred to as functional strategies, and deal predominantly with strategies in the shorter to medium term. [Chapter 13](#) discusses functional strategies within the context of strategy implementation.

The focus of this chapter is on the business level strategies, in other words, the section with a border drawn around it in [Figure 8.1](#).

Figure 8.1 Levels of strategy



8.3 Factors influencing strategic choice

When considering the strategic management framework introduced in [Chapter 1](#), the choice of strategy follows the analysis of the environment and the setting of strategic intent. As we now know, a strategy is a deliberate course of action to gain competitive advantage. A good strategy is a strategy that generates such advantages. The strategic decision-makers aim to match the organisation's resources and capabilities successfully with the opportunities in the

environment by deliberately choosing a specific strategy or a combination of strategies. Some of the factors that the strategic decision-makers consider in deciding on the strategies include:

- the available resources
- the skills of the staff
- unique capabilities within the organisation
- experience
- the organisation's competitive advantage
- the market conditions and the strengths of the competitors
- the customer needs and changing demands
- the opportunities in the industry
- the threats in the industry.

These factors are identified through a systematic process to analyse the environment, assess these factors, make sense of the context and content of the strategic plan and match the strengths with the opportunities. When an organisation chooses and implements the correct strategy, it can realise above-average returns that enable it to maximise wealth and survive in the long term. Hence, a simple explanation of strategy is that it is the route the strategic decision-makers believe will take them to their destination – the strategic intent.

Business level strategies, or competitive strategies, deal with how an organisation intends to compete in a specific industry by positioning itself in an environment that brings a competitive advantage for the organisation. Typically, when strategic decision-makers opt to compete on price or value, they decide on a type of business strategy.

Many strategy authors posit that business level strategies are more specific to organisations in single business lines, specific to those operating with a single line of business such as Mango or FlySafair. However, the strategic decision-makers can also opt for business level strategies for a portfolio of businesses. They are not mutually exclusive with corporate level strategies. The Opening case study *Competing in South Africa's airline industry* referred to Comair which follows specific business level strategies in each business unit (British Airways and Kulula.com). British Airways is a full-service airline that offers value-added services to business and leisure travellers, and intends to outperform their competitors by offering a premium service. For this airline to sustain its value proposition, it needs to continually offer a superior service for which customers are prepared to pay. Kulula.com, on the other hand, is a low-cost airline that offers lower fares and fewer comforts to travellers, with the aim of beating competitors by offering value for money at a reasonable price. To sustain their value proposition, Kulula.com needs to keep costs as low as possible.

Corporate level strategies seek to determine the appropriate blend of business ownership or corporate scope as a means of maximising stakeholder value. These strategies deal with the organisation's choices for products and markets. Corporate level strategies specify actions that organisations take to gain a competitive advantage by selecting and managing a group of different businesses competing in different markets. For example, Anglo American Corporation owns enterprises in mining, retail, media and other sectors. Another example is Barloworld Holdings, which owns enterprises in transport, logistics, equipment and automotive business segments.

In reviewing the various strategic options, the strategic decision-makers base their reviews on a set of assumptions or hypotheses about the way competition in the industry is likely to develop, and how the organisation can exploit those developments to create a competitive advantage. The greater the extent to which these assumptions and hypotheses accurately reflect how competition in this industry develops, the more likely it is that an organisation will gain a competitive advantage from implementing its strategies.⁴¹ If these assumptions or hypotheses turn out to be inaccurate, then an organisation's strategies are unlikely to be a source of competitive advantage.

Unfortunately, because of the volatility and often unpredictable nature of an industry and the organisation's competitors, it is challenging to know for sure that an organisation is choosing the right strategy, hence it is

necessary to consider the factors that may influence the choice. Before an organisation evaluates its various strategic options, it is already familiar with its unique resources and capabilities, its weaknesses, the potential sources of competitive advantage, and the opportunities and threats in the environment. The organisation's strategic intent, as captured in its vision and mission, also affects the strategic choice. Ultimately, the organisation's strategic intent is its purpose and its final destination. If an organisation's intent is to grow and become a global competitor, it will choose strategies to reach this long-term goal. The Opening case study referred to the competitive strategies of the various airline providers. Mango's CEO explained that the airline was created to get more South Africans to fly and to stimulate economic activity. Mango's objective is to reduce the cost of air travel as far as possible while remaining financially sustainable, which contributes to the decision to pursue a **cost leadership strategy**. Another example from the Opening case study is from FlySafair. This new entrant to the low-cost airline industry also builds its business level strategies on keeping costs per seat as low as possible. One of the actions to achieve this purpose was to make the seats on the aircraft lighter and thinner, which reduces fuel costs.⁴²

Another factor that affects the strategic choice is the nature of the competition in the industry. Chapter 4 explained how competitive intelligence can entrench a stronger competitive position. When the strategic decision-makers know what the competitors' strengths and weaknesses are, they can devise plans and strategies to outperform their competitors. If a major competitor has a competitive edge in its logistics and can provide its product at a cheaper rate, faster than all competing organisations in the industry, and if this edge is durable and inimitable, then the strategic decision-makers should choose a strategy that the organisation can implement through the optimal match between its resources, capabilities and opportunities.

The impact of the chosen strategy on the organisation's stakeholders is also a factor that the organisation needs to consider. Other factors that affect the choice of business level strategies are what goods or services the organisation wants to offer to its customers, how it will manufacture goods or provide the services, and how it will distribute these goods to the marketplace. The Opening case study described how Mango uses a more fuel-efficient fleet than its competitors. Using the most fuel-efficient fleet is a tactic employed by Mango to lower costs and ensure its competitive edge. This cost-efficiency tactic is similar to what FlySafair follows as well.

8.4 Business level strategies

Business level strategies are also called competitive strategies. Michael Porter introduced the business level strategies in 1980 and these are commonly known as the 'generic strategies' of cost leadership, differentiation and focus. Cost leadership and differentiation strategies can also become focused cost and focused differentiation strategies – which are depicted in Figure 8.2. In essence, these strategies inform how the organisation competes in the industry. Generic strategies are based on the breadth of the target market and the type of competitive advantage. Each of these generic strategies offers the organisation the potential to outperform competitors in the industry. The generic strategies that the strategic decision-makers can choose from are overall cost leadership, differentiation and focus strategies.

What is important to recognise is that organisations are unique entities. This means that each organisation's strategic approach consists of custom-designed actions to fit its own circumstances and industry environment. This implies that there are many variations in business level strategies. Strictly speaking, there are as many competitive strategies as there are organisations. It is highly unlikely that different organisations, even those competing in the same industry, will employ strategies that are exactly alike in every detail.

Overall **cost leadership** is a strategy that is built on low input costs. As the name implies, this strategy is built on definite efforts to reduce the costs at which the organisation is able to offer its products and services, while still making a profit. The savings from the lower costs are then transferred to a large, price sensitive market. The Opening case study *Competing in South Africa's airline industry* described how Mango, FlySafair and **Kulula.com** compete in the low-cost airline industry. The competitive strategies of all three airlines are different, but they all

compete for the same customers. They are clearly competing on cost, and their strategies are identified as cost leadership strategies.

Differentiation is a strategy that is built on unique and valued offerings. The target market tends to be smaller, but is willing to pay more for the unique offering. Further, the differentiation offers a level of value creation that makes it difficult for competitors to match. The Opening case study described how British Airways targets customers industry wide and aims to provide a superior service which customers are prepared to pay for, which is an example of a differentiation strategy.

Focus is a strategy followed by organisations that direct their competitive efforts to a specific niche in the marketplace. [Figure 8.2](#) depicts Porter's generic strategies as well as the 'focused' versions of the cost leadership and differentiation strategies. These versions essentially offer the same thing, but the scope is narrow. Organisations pursuing a focus strategy can gain competitive advantage in the niche area. In practice, these three generic strategies are translated into five strategies according to the breadth of the market and the type of competitive advantage being pursued. In the Opening case study the airline operators Airlink and CemAir were described. Both of them fly to smaller towns, cities and regional centres, and serve markets not pursued by other airlines. They can both charge higher prices for providing a niche service to a particular segment of the market, namely business travellers. The market segment is fairly narrow and the competitive advantage is created through routes to destinations not served by other airlines. This is an example of a focused differentiation strategy.

As can be seen from [Figure 8.2](#), leadership strategy or a differentiation strategy strive to attain competitive advantage industry wide, targeting a large customer base. Organisations that pursue a focused strategy, whether on cost or value, have a particular market segment in mind. Although these strategies were initially pursued as mutually exclusive, organisations soon came to realise that competitive conditions may require an integrated approach to business level strategising. The centre part of [Figure 8.2](#) depicts the integrated cost leadership/differentiation strategies. Integrated strategies combine the features of cost leadership and differentiation aimed at offering the best value to the customers. Such an integrated strategy is also referred to as strategies stuck in the middle or middle of the road strategies.

Figure 8.2 Porter's generic strategies and the focused strategies⁴³



The following is a discussion of each of these business levels or competitive strategy options. [Sections 8.4.1](#) and [8.4.2](#) discuss the broad generic strategies. The focused versions of these strategies are discussed in [section 8.4.3](#) – it is recommended to refer to [Figure 8.2](#) when reading through these sections.

The strategic decision-makers in an organisation will define their scope of operations according to the market it aims to serve. Each organisation will consider the strategic decision enablers before opting for one business level strategy over another. For example, it does not make business sense to pursue a cost leadership strategy in a small market because volumes and, accordingly, profit margins are low. However, it makes business sense for organisations like [Kulula.com](#) or Mango to pursue a cost leadership strategy aimed at a large market.

Consideration for choosing between the business level strategy options can also be in terms of cost and price, and the perceived (or real) quality or value. The quality or value can be perceived or real as long as customers are willing to pay for it. An organisation is pursuing a best-value strategy when the cost to manufacture a product is comparatively low, and the market considers it as high value.

When one strips away the details to reach the real substance, the biggest and most significant differences among generic strategies are:

- whether an organisation's target market is broad or narrow
- whether the organisation is pursuing a competitive advantage linked to low-cost or product differentiation
- a combination of the above.

8.4.1 Low cost leadership strategy

Organisations that choose cost leadership strategies aim to build and sustain their competitive advantage by reducing their costs, or keeping them lower than those of their competitors. The advantages of a lower cost base give an organisation an edge over its competitors, provided that it offers a product or service that customers want to buy. If an organisation is so intent on reducing costs and thereby produces low-quality products that no one wants to

buy, the potential advantages of the cost leadership strategy are lost. There are many examples of organisations that have successfully pursued cost leadership strategies.

The Opening case study *Competing in South Africa's airline industry* described how Comair Limited pursues competitive advantage linked to low cost through Kulula.com. Comair Limited also pursues competitive advantage linked to product differentiation through British Airways. When deciding to make a reservation with Mango, FlySafair or Kulula.com, customer choice will be influenced by the price of the service, the value and the benefits offered. Customers may choose to purchase from one source rather than another because either the price of the product or service is lower than a competitor's, or the customer perceives the product or service to provide better 'added value', such as on-board internet connectivity, mobile boarding passes or benefits that are not available elsewhere.

The Opening case study *Competing in South Africa's airline industry* introduced Kulula.com. This airline's choice of business level strategy is a low-cost provider strategy with the aim of serving a large market that is price sensitive. The main motivation for choosing this strategy is to gain a competitive advantage over competitors by maintaining a lower overall cost base. This implies a competitive edge. However, this can only be realised if the organisation's product or service appeals to a broad spectrum of customers (large market size as shown in [Figure 8.2](#)) since it is generally dependent on the economies of scale resulting from high volumes of production or owning cost-saving technologies.

This strategy is about underpricing competitors, and is also referred to as the no-frills strategy. It combines a low price, low perceived added value, and a focus on a price-sensitive market segment. It can be viable because there may well be a segment of the market which, while recognising that the quality of the product or service might be low, cannot afford or chooses not to buy better-quality goods.

The strategy may also be a viable means of competing in an industry in which major organisations are following different strategies. For example, Kulula.com grabbed an unoccupied position in the airline industry when it entered the market in August 2001, and established itself as the market leader in the South African low-cost airline market. The organisation uses a variety of cost cutting strategies to effect a no-frills strategy, which has proven to be effective and attractive to its customers.

The Case example *Chery QQ3 0.8 TE is still the cheapest car in SA* below describes how Chinese car manufacturer Chery chose a cost leadership strategy to cater for demand in a price-sensitive market.

CASE EXAMPLE: Chery QQ33 0.8 TE is still the cheapest car in SA

Cheap cars are the way forward for many South African motorists. In an effort to identify the cheapest new cars in South Africa, BusinessTech⁴⁴ put together a list of the cheapest cars on the South African market with basic prices ranging from R99 995 to R149 990.

Twelve years after introducing the Chery QQ33 to the South African market, it remains the cheapest car available. This Chinese five door super-mini car offers a rock-bottom price offering without airbags, ABS or seatbelt tensioners,⁴⁵ nor does it have niceties such as a radio or air conditioner. Consumers literally get what they pay for: a tiny three-cylinder 812cc car with no impressive performance record, and a bodysell integrity rated as 'unstable'.

When deciding whether to follow a business strategy based on cost, an organisation typically considers the potential advantages of following such a strategy. Cost advantages are possible even when competing organisations offer similar products or services. Sources of cost advantage include the following:

- In most cases, organisations choose a cost-leadership strategy because of market size and the inherent cost advantages flowing from economies of scale in manufacturing, marketing, distribution, or any other function of

the organisation. Economies of scale exist when the production cost per unit decreases as the number of units produced increases.

- Another source of cost advantage can be obtained when an organisation owns specialised machines, as in the case of Mango's fleet of fuel-efficient aircraft, to enable high levels of production. Often, these specialised machines cannot be kept in operation by small organisations.
- In many cases, the organisation's cost advantage lies in its low overhead costs – an organisation with high volumes of production can spread its overhead costs over more units and thereby reduce the overhead costs per unit.

However, low cost in itself is not a basis for competitive advantage if competitors can also achieve the same low costs. This implies that there is a need for a low cost base that competitors cannot match. The key challenge is how to reduce costs in ways that others cannot match so that a low price strategy might give sustainable advantage. PEP Stores formed a joint venture with Abacus Insurance to maintain a low-cost base. PEP broadly proclaims that they keep their margins low and have a low-cost culture throughout their organisation. The low-cost strategy is thus reinforced throughout their offerings. Another example of an organisation pursuing a low-cost strategy is the Botswana-based retailer, Choppies. This retailer avoids the costs of expensive shop fittings and wide ranges of products. Rather, the costs saved through offering items in bulk in a no-frills shopping environment are transferred to the customers and thereby sets Choppies apart from a retailer such as Spar.

The Case example *Low price insurance for the people* below refers to off-the-shelf, cash prepaid insurance policies aimed at PEP Stores customers who do not have bank accounts. PEP Stores is well known for value for money and lower prices. By introducing the insurance policies, PEP Stores management has extended their offering, and now offer a low-cost alternative for insurance.

CASE EXAMPLE: Low price insurance for the people

By using the PEP distribution network, which includes more than 1 504 retail stores in southern Africa,⁴⁶ handset insurance is made easy, convenient and affordable by PEP. Given that PEP sells more prepaid handsets in South African than all the other retailers combined,⁴⁷ it made business sense to join forces with Abacus Insurance to offer cover for loss, theft or accidental damage for handsets worth R495 or more. This venture into handset insurance follows on the initiatives with Hollard Insurance to offer comprehensive funeral plans to individuals and families who do not have a bank account. When the funeral policies were launched, PEP offered insurance starter packs at R19.99 per month that contained a barcoded insurance card with a dedicated insurance hotline number so that clients can talk to trained insurance professionals in their home language. Clients get immediate cover and pay premiums at till points in any of the PEP stores.

8.4.1.1 Advantages of cost leadership strategy

Hill and Jones⁴⁸ mentioned that the advantages of the business level strategy are best discussed in terms of Porter's five forces model. These:

- threats from competitors
- powerful suppliers
- powerful buyers
- substitute products, and
- new entrants.

When pursuing a cost leadership strategy, the cost leader is protected from industry competitors by its cost advantage. If there are powerful suppliers, the cost leader's lower costs also mean that it will be less affected than its

competitors by increases in the price of inputs. Moreover, since cost leadership usually requires a big market share, the cost leader purchases in relatively large quantities, increasing its bargaining power over suppliers. Further, if the bargaining power of buyers is high, the cost leader is less affected by a fall in the price it can charge for its products. If substitute products start to come into the market, the cost leader can reduce its price to compete with them, and retain its market share. Finally, the cost leader's advantage constitutes a barrier to entry since other organisations are unable to enter the industry and match the leader's costs or prices.

The cost leader is therefore relatively safe as long as it can maintain its cost advantage, and while price is the key for a significant number of buyers.

8.4.1.2 Disadvantages of the cost leadership strategy

We have already stated that organisations are faced with challenges presented by change in the competitive environment. The principal dangers of the cost leadership strategy can be identified in competitors' abilities to find ways to produce at a lower cost and beat the cost leader at its own game. Keep in mind that the rival organisation also engages with the various strategic options, and devises ways to outcompete its competitors. For example, competitors may also draw a cost advantage from labour cost savings. Foreign competitors in developing countries have low labour costs. Many organisations now assemble their products abroad as part of their low-cost strategy – many are forced to do so simply to compete. Competitors' ability to easily imitate the cost leader's methods is another threat to the cost leadership strategy.

The cost leadership strategy carries a risk that the cost leader may be so focused on reducing costs that it may lose sight of what the customers actually want. Thus, an organisation may make decisions that decrease cost but dramatically affect demand for the product. The cost leader cannot abandon product differentiation, and even low-cost, low-priced products cannot be too inferior to the more expensive products if the low-cost, low-price policy is to succeed.⁴⁹

8.4.2 Differentiation strategy

The **differentiation strategy**, which is also referred to as the premium strategy aims to produce products and services considered unique across the industry. A differentiation strategy may be achieved in a number of ways. For example, the uniqueness may be based on dimensions widely valued by the customers. The aim is to achieve higher market share than competitors, which in turn could yield cost benefits by offering better products or services at the same price. Alternatively, the aim could be to enhance margins by pricing slightly higher. This strategy may be achieved through improvements in products that render them unique. This requires an investment in research and development (R&D) and design expertise. Another approach is to demonstrate how the product or service meets customer needs better than that of the competitor. This approach builds on the power of the brand and can use powerful promotional approaches. The last approach is for the organisation to base its differentiation efforts on the organisation's own competencies.

The extent to which these approaches will be successful is likely to be dependent on a number of factors, such as the customer and what they perceive as value that they are prepared to pay for, competitors and inimitability. It is important to clearly identify the customer. For example, for a newspaper business is the customer the reader of the newspaper, the advertiser, or both? They are likely to have different needs and values. In deciding to follow a strategy of differentiation, the organisation needs to consider on what to base the strategy. It is also important to have a clear understanding of what is valued by customers or what customers are willing to pay for. Organisations may pursue strategies either on the basis of traditional ways of operating and taken-for-granted assumptions rooted in experience, or on the basis of resources and skills that the organisation has. Before choosing to follow a strategy of differentiation, an organisation needs to ask the basic question: what does the customer value? The organisation may conceive of a strategy of differentiation in technical terms, for example as a better-engineered product. While the uniqueness may be real in technical terms, it is of no more value to the user than products or services of

competitors. Indeed, a differentiating factor for an organisation may be the ability of the strategic decision-makers to be closer to the market than competitors so that they can better sense and respond to customer needs.

Another factor to consider when deciding on a differentiation strategy is the competitors. For example, is the business competing with a wide competitor base or with a much narrower one, perhaps within a particular market segment? In the case when an organisation differentiates for a broad range of customer preferences, the strategy is referred to as broad-based differentiation. Broad-based differentiation is applied across an industry in markets with a broad range of customer preferences. A good example of a company that successfully pursues broad-based differentiation is Starbucks. Not only is the coffee brewer known for tailoring variations of coffee according to broad customer preferences, but it is also recognised for its quality products and service levels, for all of which customers are prepared to pay a premium. If the competitor base is narrow, a strategy of focused differentiation (see [section 8.4.3.2](#)) may be appropriate.

A further problem in identifying relevant competitors occurs as markets globalise. For example, a company may find its bases of differentiation eroded by another company that it did not previously see as a competitor because it did not share common geographic markets. As the two organisations increase their geographic scope, they may become competitors. Another possibility is that a competitor develops a basis of differentiation in one market and then enters another market on the basis of this. An example in the South African fashion industry is the luxury design brand Jo Borkett. Previously, Jo Borkett clothing was only available in its few boutique outlets but by entering into a sales agreement with Edgars, Jo Borkett designs are available in more geographic regions than competing luxury designs. This challenges an established organisation's strategic position.

Another important factor to consider is the extent to which the basis of differentiation is difficult to imitate. An organisation needs to base its decision on the sustainability of the competitive advantage. It may have to reconsider its strategic options if the bases of a specific strategy can be easily imitated by competitors. Although one can find a wide range of camping equipment manufacturers offering lanterns, stoves or sleeping bags, Coleman has differentiated itself from competitors by continuously offering a more superior product. Not only does Coleman own patents that protect the uniqueness of its products, but competitors also find it difficult to imitate the reliability and durability offered by Coleman. Cheaper brands are likely to have problems – at a time when a camper needs it most.

[Figure 8.2](#) distinguished between differentiation and focused differentiation – the main difference is the market size being targeted. Traditionally, when describing differentiation across a large market, scholars refer to broad differentiation. When describing differentiation across a narrow market, they refer to focused differentiation. The following two sections offer a description of these two types of differentiation.

As stated above, a differentiation strategy aimed at a large market depends on meeting customer needs in unique ways. The uniqueness of the offering offers a competitive edge over competitors. One way of achieving a differentiated product is to incorporate tangible features that increase customer satisfaction. Examples in the cellphone industry testify to added features that enhance functionality and become the deciding factor between a Sony Experia, Samsung or Apple iPhone. These cellphone manufacturers are in a constant race to introduce and offer functions that outdo those of rivals. The added value can also be based on intangible features. For example, the function of a motor vehicle is to offer transport, yet by opting to purchase a vehicle with low carbon dioxide emissions, the satisfaction of the environmentally conscious driver is achieved in an intangible way along with the basic requirement of transport. This implies a product offering that contributes to the environmental sustainability cause while appealing to an environmentally conscious market that is prepared to pay more for the reduced carbon dioxide features.

To be successful in a broad differentiation strategy, the organisation needs to possess strengths and capabilities that create superiority that customers are willing to pay for. The most successful approaches to differentiation are those that are difficult to duplicate by competitors. The brand image of the Ford Mustang is built on a rich history and tradition. A new entrant to the performance car market may need to find another source of differentiation as the Ford Mustang brand is difficult to imitate. Differentiation that is linked to high switching costs also warrants

further attention. For example, there are a number of open source software packages available for office products such as word processing and presentations, yet the market for Microsoft Office products continues to grow as they offer superior features and easier integration than the free open source products do.

8.4.2.1 Advantages of differentiation strategies

When organisations pursue a **differentiation strategy**, the organisation experiences some protection against competitors to the degree that customers develop brand loyalty towards its products. Customers may become so used to the added features that any other product offering less is not good enough. Many can identify with Discovery Health, which offers additional benefits and features such as Vitality, discounts on selected items at some retailers, car insurance, life insurance and now banking. Having to switch to an alternative medical aid might imply a loss of these benefits, hence Discovery has established brand loyalty on the part of the customers. Brand loyalty is a valuable asset that can offer a competitive advantage over competitors. Powerful suppliers are rarely a problem because the differentiated organisation's strategy is geared more towards the price it can charge than towards the costs of production. Customers are price insensitive because they want the added features of the differentiated product, and are prepared to pay for them. A differentiator can thus tolerate moderate increases in the prices of its inputs better than the cost leader, who needs to keep prices as low as possible. An organisation pursuing a differentiation strategy is also unlikely to experience problems with powerful buyers because the differentiator offers the buyer a unique product which translates in brand loyalty. Differentiators can pass on price increases to customers because customers are willing to pay the premium price. The threat of substitute products depends on the ability of competitors' products to meet the same customers' needs as the differentiator's products and to break customers' brand loyalty. For example, a customer may have been a loyal Apple customer because of its unique features and simple interface, yet that same customer may opt to switch to an Android-based platform as it offers similar features that integrate more easily with some other platforms. The issue is how much of a premium price can an organisation charge for uniqueness before customers switch products? In a period of economic recession, customers may reconsider their preparedness to pay for added features and switch to a cheaper brand. Finally, differentiation and brand loyalty also create a barrier to entry for other organisations seeking to enter the industry. New organisations are forced to develop their own distinctive competency to be able to compete, and doing so is expensive.⁵⁰

8.4.2.2 Disadvantages of differentiation strategies

The main problems with a differentiation strategy centres on the organisation's long-term ability to maintain its perceived uniqueness in customers' eyes. It became evident in the last 10 years how quickly competitors move to imitate and copy successful differentiators. For example, in 2005 OUTsurance was one of the first short-term insurers to introduce a no-claim bonus in South Africa. Soon after, Budget Insurance and MiWay introduced similar concepts, closely followed by 1st for Women, which introduced differentiated insurance packages.

A strategy of differentiation, then, requires the organisation to develop a competitive advantage by making choices about its product, market and distinctive competency that reinforce each other and together increase the value of a good or service in the eyes of the customers. When a product has uniqueness in customers' eyes, differentiators can charge a premium price.

When differentiation stems from the design or physical features of the product, differentiators are at great risk because imitation is easy. Over time, the product features may not be worth the premium price in the eyes of the customers, thus the importance of differentiation diminishes as customers become more price sensitive. Think about Tupperware and its wide range of products that have become household items over the last 50 years. Tupperware offers innovative products with practical designs and a lifetime guarantee. Over the years, many organisations introduced similar products with similar features, but at a lower price. Some organisations even offer disposable plastic ware at a very low cost.

When differentiation stems from an intangible source, such as the quality of service, reliability or prestige, an organisation is much more secure. It is difficult to imitate intangibles, and the differentiator can reap the benefits of this strategy for a long time. Nevertheless, all differentiators must watch out for imitators, and be careful that they do not charge a price higher than the market will bear.

8.4.3 Focused strategies

In some cases, neither a low-cost leadership strategy nor a differentiation strategy is possible for an organisation across the broad range of the market, as discussed in [sections 8.4.1](#) and [8.4.2](#) above. An organisation may find itself in a situation where the funds to invest in specialised machinery or high volume production are not available. Similarly, an organisation may find the costs of differentiation too high. For these and related reasons, it may be better to adopt a focus, also called a niche, strategy. Focus strategies are typically followed when the organisation focuses on a specific niche in the marketplace, and develops its competitive advantage by offering products especially developed for the niche. [Figure 8.2](#) depicted the ‘focused’ versions of cost leadership and differentiation. This section describes the focused cost leadership strategies and the focused differentiation strategies.

A [focus strategy](#) aimed at securing a competitive edge based either on low cost or offering best value becomes increasingly attractive when the target market niche is big enough to be profitable and offers good growth potential. The focus strategy is also attractive when industry leaders do not see that having a presence in the niche is crucial to their own success. In this case, focusers can often escape battling head-to-head against some of the industry’s biggest and strongest competitors.

Focus strategies are also viable options when it is costly or difficult for organisations that compete in multiple markets to put capabilities in place to meet the specialised needs of the target market niche and, at the same time, satisfy the expectations of their mainstream customers. This implies that an organisation opts to ‘focus’ on a specific product, market or service offering. When the industry has many different niches and segments, such as the motor vehicle industry, an organisation has the option to focus on a competitively attractive niche suited to its resource strengths and capabilities. For example, Rolls Royce specifically focuses on the luxury end of the industry whereas Chery opts for the lower end. With more niches, there is more room for focusers to avoid each other in competing for the same customers. Another example of a focus strategy is the intercity transport service provider, African People Mover (APM). The Case example describes how APM developed a service model that revolves around the passenger, and offers great value for money.

The strategic decision-makers will also consider the focus strategy when there are few, if any, other rivals attempting to specialise in the same target segment – a condition that reduces the risk of segment overcrowding. A final consideration in choosing a focus strategy deals with the focuser’s ability to resist challengers. The focuser can compete effectively against challengers based on the capabilities and resources it has to serve the target niche and the customer goodwill it may have built up.

CASE EXAMPLE: Africa People Mover

Established in 2014, Africa People Mover (APM) entered the intercity transport market with a desire to offer passengers safe arrival on time. Their philosophy is simple: affordable, safe and simple travel through the commitment of their drivers, technicians and mechanics. APM launched its first service from Pretoria to Durban on 12 December 2014. Not only did this day represent the launch of their intercity service, but also the promise of a clean bus driven by a courteous and uniformed driver that departs on time from a well-located sales office, travels safely and arrives on time without incident.⁵¹ Within their first 365 days of operations, they had no accidents and no injuries to the over 54 000 passengers they ferried.⁵² What makes APM a unique organisation is its focused approach to offering transport at a reliable and affordable rate – taking on the added responsibility of making sure the jobseeker makes it on time for his interview, an entrepreneur clinches that game-changing

deal, a senior citizen can access a healthcare facility in a metropolitan area, a student can travel back to university, a single mother travelling with an infant feels welcome in any of their services⁵³ ... APM confirms that they will not sacrifice safe operations in favour of high turnover – their strategy is to focus on the market that needs safe, reliable and on-time travel.

8.4.3.1 Focused cost leadership

When choosing a focused strategy based on low cost, the strategic decision-makers choose to concentrate on a narrow buyer segment and attempt to outcompete competitors by having lower costs. The **focused cost leadership strategy** is an attractive strategy when the target market is interested in the lower price product or service. The organisation is therefore able to serve niche customers at a lower price. Ultimately, organisations following a focused cost leadership strategy create better value for their customers. A number of examples of such strategies are found in the hotel and tourism industry. Within the Tsogo Sun Hotel group, the StayEasy hotel chain offers smaller rooms with fewer features than the SunSquares and Garden Courts. The price is adapted to reflect the number of features, services and amenities. The most budget-conscious offering is through SUN1 that offers an option for travellers seeking comfortable hotel accommodation at the cheapest rates. SUN1 hotels offer simple comfort, great value and convenient locations around South Africa. Overall, SUN1 offers hotel accommodation for up to three people sharing at less than R600 per night.⁵⁴ As alluded to earlier, competitors will respond to focused cost leadership strategies through their own attempts at securing the narrow market segment. For example, within the City Lodge Hotel Group, the Road Lodge hotel chain also targets customers seeking comfortable accommodation at the cheapest rates – competing against Tsogo Sun's SUN1.

8.4.3.2 Focused differentiation strategies

With a focused differentiation, the market size is small and distinguished. The market is a well-defined group of buyers, and the product or service is designed to appeal to them. With this strategy, the aim is to concentrate on a narrow buyer segment and to outcompete competitors by offering niche customers customised attributes that meet their requirements better than the competitors' products. Successful use of a focused differentiation strategy depends on the existence of a buyer segment that wants special product attributes or seller capabilities and on an organisation's ability to stand apart from rivals competing in the same target market niche. For example, Edcon Group's Charter Club brand is an example of a high-quality, exclusive range for a narrow market. Another example is the emergent boutique hotel industry – hotels not affiliated with a hotel chain and offering luxury facilities of varying size and stylish appearance, with impeccable amenities in unique settings.

Another example of an organisation that pursues a focused differentiation strategy is Harley-Davidson. With such a strategy, Harley-Davidson gained a competitive advantage and concentrated on niches such as customised touring and standardised motorcycles in the heavyweight motorcycle market. Harley-Davidson manufactures and sells custom cruiser and touring motorcycles that feature leading-edge styling, innovative design, a distinctive sound and superior quality with the ability to personalise.⁵⁵

8.4.3.3 Advantages of focus strategies

According to Hill and Jones,⁵⁶ and using Porter's five forces model, a focused organisation's competitive advantages stem from the source of its distinctive competency efficiency, quality, innovation or responsiveness to customers. The focus strategy creates a barrier to the organisation against its competitors to the extent that it can provide a product or service they cannot. This ability also gives the organisation pursuing a focused strategy power over its buyers because they cannot get the same thing from another organisation in the industry. With regard to powerful suppliers, a focused organisation is at a disadvantage because it buys in small volumes and thus is in the suppliers'

power. However, as long as it can pass on price increases to loyal customers, this disadvantage may not be a significant problem. The development of customers' loyalty also lessens the threat from substitute products. Finally, potential entrants have to overcome the customer loyalty that the focuser has generated.

This protection from the five forces allows the focuser to earn above-average returns on its investment. Another advantage of the focus strategy is that it permits an organisation to stay close to its customers and respond to their changing needs. The difficulty a large differentiator sometimes experiences in managing a large number of market segments is not an issue for an organisation with a focused strategy.⁵⁷

8.4.3.4 Disadvantages of focus strategies

There are some disadvantages inherent to focus strategies. The first deals with the production costs: since a focuser produces in small volumes, its production costs often exceed those of a low-cost organisation. Higher costs can also reduce profitability if a focuser is forced to invest heavily in developing a distinctive competency to compete with a differentiated organisation. However, once again, flexible manufacturing systems are opening up new opportunities for organisations pursuing a focus strategy because small production runs become possible at a lower cost. Increasingly, small specialised organisations are competing with large organisations in specific market segments in which their cost disadvantage is much reduced. An example is a boutique fashion designer competing against boutique offerings through large retailers such as Zara and Woolworths. A second problem is that the focuser's niche can suddenly disappear because of technological change or changes in consumers' tastes. Unlike the more generalist differentiator, a focuser cannot easily move to new niche markets, given its concentration of resources and competency in one or only a few niches. For example, a Mexican restaurant would find it difficult to move to serving Chinese food if customers' tastes changed.

Finally, there is the prospect that differentiators will compete for a focuser's niche by offering a product that can satisfy the demands of the focuser's customers. A focuser is vulnerable to attack, and therefore has to defend its niche constantly.

8.4.4 Integrated cost leadership/differentiation strategies

In some cases, neither a low-cost leadership strategy nor a differentiation strategy is possible for an organisation that competes across the broad range of the market, and it is necessary to combine the best of both strategies. Referring back to the motor vehicle industry, one can find many examples of one supplier offering cars for the lower as well as the luxury end of the market. An organisation may find itself in a situation where the funds to invest in specialised machinery or high-volume production are not available (cost leadership strategy). Similarly, an organisation may find the costs of differentiation too high (differentiation strategy). Often, the complexity of the competitive environment may force an organisation to offer a differentiated product or service while also operating with low costs, hence an integrated strategy. Integrated strategies combine low-cost strategies with differentiation strategies. Pursuing an integrated strategy depends on the organisation's ability to develop capabilities and competencies across all its functions. [Figure 8.2](#) depicted the integrated strategies in the middle of the diagram, hence such integrated strategies are often also referred to middle ground business strategies or stuck in the middle business strategies. The integrated strategies aim to reach a large group of value-conscious buyers who are looking for a very good product at an affordable price. This implies an orientation towards best value (i.e. added features at a reasonable price) and not lowest price. Originally it was thought that business level strategies should be pursued as mutually exclusive, but the business environment offers many examples of organisations that could successfully pursue a combination of these strategies. For example, Toyota uses its low costs to provide greater differentiation and then reinvests those profits to lower its costs even further, while still offering a differentiated product for which customers are willing to pay more.

With integrated strategies, the organisation needs the resources and capabilities to add attractive attributes to their products or services at lower costs than competitors. Sorbet Beauty Salons South Africa⁵⁸ entered the market

in 2005 with six stores and in 10 years the brand grew to 116 stores. Sorbet Beauty Salons is a strong example of an organisation that successfully pursues integrated strategies – while offering a wide range of products at affordable prices, it also appeals to the customers by being involved in communities, empowering female entrepreneurs and rewarding loyal customers through earning loyalty points.

8.4.4.1 Advantages of integrated strategies

Integrated strategies offer a number of advantages to the organisation that is able to pursue them successfully. If an organisation is able to integrate cost leadership and differentiation, it is able to establish, build and strengthen its competitive advantage over its competitors. Essentially, the competitors may find it more difficult to imitate. As with the Toyota example mentioned above, the organisation is able to reduce its costs while continuing to charge a premium for its products – this impacts positively on the profit margins and bottom line. The benefit of being known as the best value provider in a market also adds to the success of the organisation in terms of its image.

8.4.4.2 Disadvantages of integrated strategies

As stated earlier, it is risky to pursue integrated strategies, and many organisations have failed in their attempts. The biggest disadvantage is the vulnerability of the organisation as it is competing on a number of fronts and may lose focus. It is also possible that an organisation finds itself stuck in the middle by not being great at offering a differentiated product nor keeping costs low. Pursuing integrated strategies often ends up in failure because the organisations succeed at neither a differentiation nor a cost leadership strategy. Improved product features, customisation and customer service come at a higher cost while offering no-frills products comes at reduced perceived value. The Opening case study *Competing in South Africa's airline industry* included SAA and SA Express. Some may argue these airlines find themselves stuck in the middle, trying to compete against competitors with differentiated products while their costs continue to increase and they struggle to offer the real value that customers are willing to pay for.

STRATEGY IN ACTION: Capitec – providing cheap and simple banking solutions



Capitec entered the South African banking industry in 2001 knowing that it would be a David against four Goliaths – Absa, Standard Bank, Nedbank and First National Bank. Yet within 16 years, Capitec not only disrupted the market, but also conquered some of the Goliaths. During 2017, Capitec was rated the world's best bank by the Lafferty Group's Global Bank Quality benchmarking study. Also, in the same year Capitec overtook Nedbank as the country's fourth largest bank by value. Capitec's business model is structured on low costs, and it provides cheap, simple banking solutions mostly at a lower cost than its competitors. The bank is innovative in terms of keeping the costs low – such as offering a paperless banking experience, using biometrics to secure and verify client details, issuing cards and credit in real time with no waiting period, and using machine-learning techniques in its risk-based credit models.⁵⁹ Its overall aim is to create sustainable value over the long term for all who have an interest in its business. Capitec aims to achieve this sustainable value by providing a unique service, enhancing its products, growing the transaction income, managing the cost of credit to its clients, and responsible management of regulatory and compliance risk.⁶⁰

Capitec sets out to help clients manage their financial lives better through its focus on providing them with the ability to make better decisions and better manage their money. Capitec offers clients transparency in terms of what they get and what they pay for. For example, Capitec offers Global One – a single solution to money management. Clients get the entire Global One offer at a monthly fee of R5.25. This means that every client can open and operate a transaction account and four savings accounts, gain access to credit, cellphone banking and internet banking for this fee, with a fixed fee per transaction. Capitec offers extended branch hours, and branch managers are located on the branch floor to ensure they remain in touch with both client needs and service

logistics. The combination of a simplified product offer and a simplified service process means the bank can deliver on client needs at an efficiency level well above the norm. This in turn means that Capitec remains aggressive on its pricing strategy, enabling it to be a price leader in the industry. By the end of 2016, Capitec had not increased fees on remote banking for two years and increased cashless transaction fees by less than 5% for the past three years.⁶¹

Questions:

In addition to the information provided above, use the internet to gather more information on Capitec and the South African banking industry. Answer the following questions:

1. Comment on the business level strategies pursued by Capitec. Identify the strategies and comment on the factors that influenced the strategic choice.
2. Are the strategies pursued by Capitec in line with the strategic direction of Capitec Bank Holdings Limited group? Why or why not?
3. Can these strategies easily be copied by competitors? Why or why not?
4. Comment on how Capitec can prepare itself against the threat of new entrants to the banking industry.

The contents of this section on the business level strategies is best summarised as shown in [Table 8.1](#). When reviewing [Table 8.1](#), keep in mind that business level strategies deal with the organisation's plans to compete successfully. The strategic decision-makers may decide on a business level strategy or a combination of these strategies. When choosing a strategy, the strategic decision-makers can evaluate each strategy option based on a set of criteria that considers the organisation's strategic direction, goals, resources, capabilities, the opportunities in the environment and the competitors.

[Table 8.1](#) summarises the distinctive features of business level strategies. The first column shows the feature, and the actual features within the strategies are given in the same line under each new column.

[Section 8.4](#) discussed business level strategies. As can be seen from the discussion, these strategies deal with how the organisation competes in the industry. Choosing strategies requires careful consideration of the organisation's resources, capabilities, products and services, and matching these with the opportunities in the customer market. The following section deals with the criteria to consider when evaluating strategies.

Table 8.1 Distinctive features of business level strategies⁶²

Type of feature	Overall cost leadership	Differentiation	Focus	Integrated cost leadership/differentiation (best value)
Strategic target	A broad cross section of the market	A broad cross section of the market	A narrow market niche where buyer needs and preferences are distinctively different from the rest of the market	Value-conscious buyers

Type of feature	Overall cost leadership	Differentiation	Focus	Integrated cost leadership/differentiation (best value)
Basis of competitive advantage	Lower costs than competitors	An ability to offer buyers something different from competitors	Lower cost in serving the niche (focused low cost) or an ability to offer niche buyers something customised to their requirements and tastes (focused differentiation)	Give customers more value for the money
Product line	A good basic product with few frills (acceptable quality and essential features)	Many product variations, wide selection, strong emphasis on the chosen differentiating features	Customised to fit the specialised needs of the target segment	Good to excellent attributes, several to many upscale features
Production emphasis	A continuous search for cost reduction without sacrificing acceptable quality and essential features	Invent ways to create value for buyers, strive for product superiority	Tailor-made for the niche market	Incorporate upscale features and attributes at low cost
Marketing emphasis	Try to make a virtue of product features that lead to low cost	Build in whatever features buyers are willing to pay for Charge a premium price to cover the extra costs of differentiating features	Communicate the focuser's ability to satisfy the buyer's specialised requirements	Under-price rival brands with comparable features

Type of feature	Overall cost leadership	Differentiation	Focus	Integrated cost leadership/differentiation (best value)
Sustaining the strategy	Economical prices/good value. All elements of strategy aim to contribute to a sustainable cost advantage – manage costs down, year after year, in every area of the business	Communicate the points of difference in credible ways Stress constant improvement and innovation to stay ahead or imitative competitors Concentrate on a few key differentiating features; tout them to create a reputation and brand image	Remain totally dedicated to serving the niche better than other competitors; do not blunt the organisation's image and efforts by entering segments with substantially different buyer requirements or adding other product categories to widen market appeal	Unique expertise in managing costs down and product/service calibre up simultaneously

8.5 Evaluating strategies

As stated earlier, an organisation bases its choice of strategy on various factors. The strategic decisions-makers will consider the various **strategic options** in conjunction with the strategic direction and objectives of the organisation. Once the strategic decision-makers have selected potential strategies, they need to evaluate these options to choose the most appropriate strategy or combination of strategies. The content of these strategy options needs to be evaluated for its contribution to the organisation's objectives. Because organisations are unique entities, the strategic decision-makers may develop their own set of criteria to evaluate the strategy options. This section considers how the strategic decision-makers may assess whether or not a business or corporate level strategy is effective or likely to be effective. The criteria discussed here are used to evaluate strategies for innovation (discussed in [Chapter 9](#)) as well as corporate level strategies (discussed in [Chapter 10](#)).

Thompson and Martin⁶³ offered three criteria to evaluate a strategic option, namely concern appropriateness, feasibility and desirability. According to these authors, some of these criteria are likely to conflict with each other, and consequently an element of judgement is required when making a choice. The most appropriate or feasible option for the organisation may not be the one that it regards as the most desirable. Lynch⁶⁴ expanded on these three criteria by adding additional considerations, namely consistency, especially with the strategic intent of the organisation, validity and attractiveness to stakeholders.

8.5.1 Appropriateness

Appropriateness of a strategy is also often referred to as the suitability of the strategy. A strategy should be appropriate to the context of the organisation, both internally and externally. Appropriateness is concerned with whether a strategy addresses the key issues of the organisation's strategic position. According to Johnson, Scholes and Whittington,⁶⁵ when considering whether a strategy is appropriate, the organisation needs to assess:

- the extent to which a strategy option fits with key drivers and expected changes in the environment

- whether the strategy option exploits strategic capabilities
- whether it is appropriate in the context of stakeholder expectations and influence, and cultural influences.

As stated earlier, the organisation will already have considered the capabilities and stakeholder expectations during the preceding stages in the strategic management process. It will also have identified the environmental influences and taken these into account when considering strategic options. Hence, before an organisation can test a strategy for appropriateness, many of the issues addressed in this test will have been raised earlier in the strategic management process.

There are several tools an organisation can use to test a strategy for appropriateness. These include the SWOT (strengths, weaknesses, opportunities and threats) matrix, decision trees and scenarios. [Chapters 4, 5, 6 and 7](#) discussed the processes for strategic analysis that provide input to the tools discussed below.

8.5.1.1 The SWOT matrix

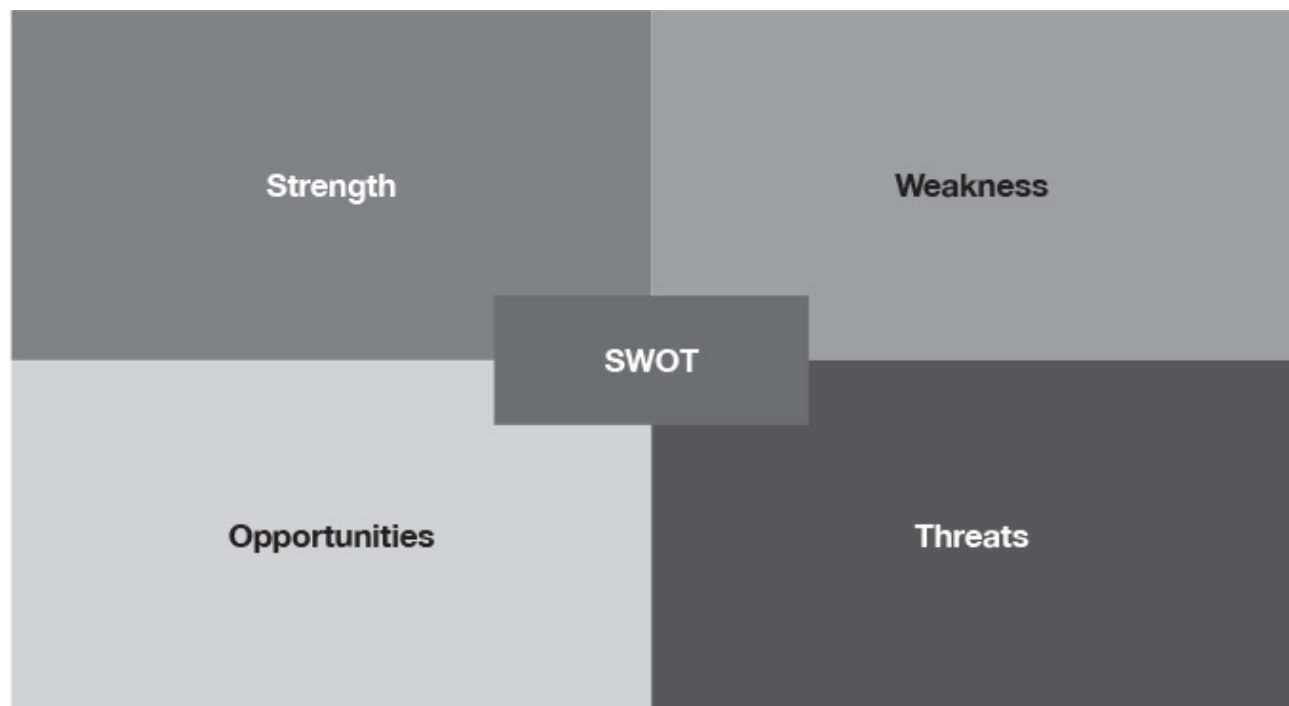
The SWOT matrix requires involvement of managers and stakeholders in various sectors of the organisation. This matrix builds directly on the information gathered during the internal and external environmental analyses. From the internal analysis of resources and capabilities ([Chapter 7](#)), the organisation identifies its relative strengths and weaknesses. From the external analysis ([Chapters 5 and 6](#)), it identifies opportunities and threats.

[Figure 8.3](#) depicts the SWOT matrix. The organisation uses each quadrant of the SWOT matrix to identify options that address a different combination of the strengths, weaknesses, opportunities and threats. It generates strategic options by determining suitable strategies for each of the four quadrants. The SWOT matrix does not give an indication of which strategic option to choose, but it does guide the organisation as to its viable options. Clockwise, the quadrants are numbered 1 to 4:

- Quadrant 1 is characterised by strengths and opportunities (SO).
- Quadrant 2 has weaknesses matched with opportunities (WO).
- In quadrant 3 the organisation is both weak and externally threatened (WT).
- Quadrant 4 features strengths and threats (ST).

What does this all mean? Simply, the most attractive area in which to operate is quadrant 1. Businesses operating here are the most fortunate and deserve strategic attention. However, in the real world, it may not always be as clear cut as this. Organisations may operate mostly in one quadrant while being positioned in parts of the others. Ultimately, the SWOT matrix is an analytic tool to inform business decisions. The organisation operating in quadrant 2 needs to overcome its weaknesses before embarking on opportunity exploitation. Quadrant 3 is the worst possible scenario, while there is a question mark in quadrant 4 since the organisation is threatened by, say, competition despite internal strengths. Strategically therefore strategists can map their businesses on [Figure 8.3](#) and act accordingly.

Figure 8.3 The SWOT matrix⁶⁶



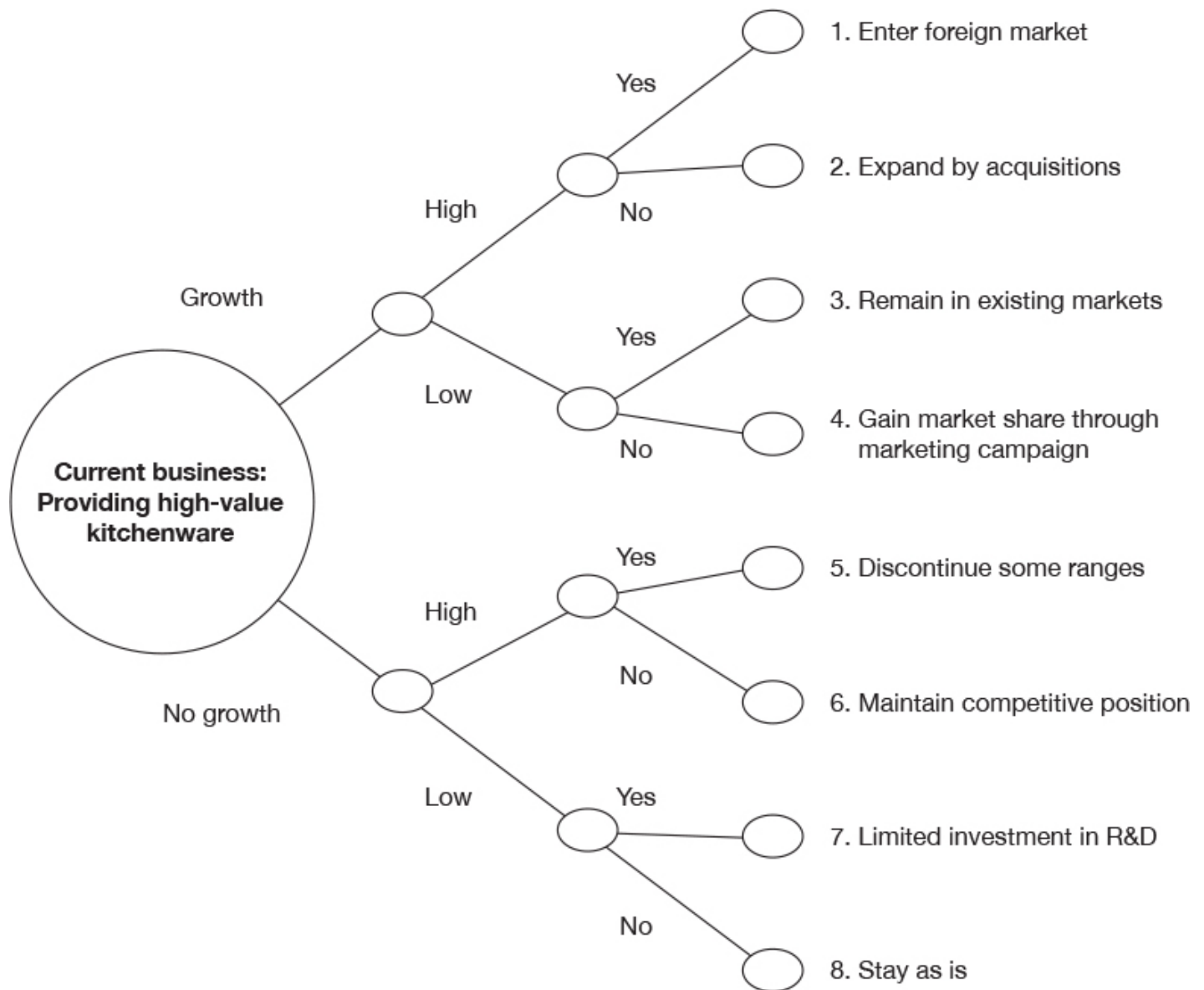
8.5.1.2 Decision trees

A decision tree offers a graphical presentation of the various strategic options available. It is used to estimate the outcome of the possible strategies. Organisations use decision trees to eliminate options by progressively introducing requirements that must be met, such as growth, investment, or diversity.

For example, an organisation may decide to pursue a differentiation strategy. Some events may occur such as new competitors entering the market, legislative changes that affect the organisation's product, or the economy going into a recession. The organisation then needs to make a subsequent decision about the strategy. This decision may be to invest more in research and development to design added features to pursue the differentiation.

Decision trees assist organisations to make the initial decision and then to consider the range of events and subsequent decisions that may occur or be necessary. A decision tree is a method to break down decisions into smaller subsets. It can also be used for forecasting. [Figure 8.4](#) illustrates an example of a decision tree. To draw a decision tree, one starts with the decision (growth or no growth). From [Figure 8.4](#), the growth decision implies a further set of scenarios (high or low growth). Each of these then leads to further options to consider with potential outcomes. A decision tree provides an effective method to enhance decision-making as it clearly lays out the problem (strategic option) and the possible options to deal with it.

Figure 8.4: An example of a decision tree



8.5.1.3 Scenarios

Scenario analysis ([Chapter 4](#)) is a useful tool that forms part of the basic strategic management process in many organisations. It explores ‘what if’ questions for their impact on the strategy under consideration. A good example of scenarios set for the contemporary South African business environment is found in the Indlulamithi South Africa 2030 scenarios.⁶⁷

8.5.2 Feasibility

Feasibility means that the organisation is capable of carrying out the proposed strategies. Questions that the organisation needs to ask when considering the feasibility of a strategy include the following:

- Is the strategy capable of achieving the objectives that it addresses?
- Can the strategy be implemented effectively and efficiently?
- Do we have the resources to implement this strategy?

When testing a strategy or strategies for feasibility, the organisation evaluates it in terms of the finance and resource availability, its ability to meet the industry and customer demands, and if the strategy can lead to and/or sustain competitive advantage. An organisation may lack the technical skills for the strategic option, or the success of the strategic option may depend on government approval. For example, when Telkom Media considered the strategic option to diversify into the pay television market, the feasibility of this strategy was dependent on the granting of a broadcast licence by ICASA. Because of the uncertainty with regard to the granting of this licence, then CEO Reuben September decided not to follow this strategy. Later, Telkom revisited the decision and opted to partner with DStv to bring Showmax to its customers – a feasible strategy given that it had the necessary resources to pursue it.

Another example, as described in the Opening case study *Competing in South Africa's airline industry*, is Fastjet. The founder of easyJet, Stelios Haji-Ioannou, indicated his backing of a new budget airline to serve the African continent. Given that up to 2011, low-cost carriers only occupied 9% of the African market, the potential for a new airline to serve the African skies is high. Further, Fastjet can start operations using existing networks in Ghana, Kenya, Tanzania and Angola, which makes this a feasible strategy to consider.

8.5.3 Desirability

Desirability relates to assessing the ability of the strategy to produce results in either the short or the longer term in light of the needs and priorities of the organisation. Desirability also relates to the risk in terms of vulnerability and timing. Thompson and Martin⁶⁸ stated that where an organisation identifies an opportunity and needs to act quickly, the danger exists that it may overlook some considerations. There may be inherent risks in the possible retaliation of competitors, or there may be risks involved in overstretching resources through diversification. Another risk may be the cash flow and the organisation's borrowing requirements that are sensitive to the organisation's ability to forecast demand accurately.

8.5.4 Consistency

When an organisation considers consistency, it looks at whether the strategy option is in accordance with the strategic intent and objectives of the organisation. For example, Telkom's strategic direction is to be a leading customer- and employee-centred information communications and technology (ICT) solutions service provider. Diversifying into the pay-TV industry may be a strategic option, but it is not consistent with Telkom's overall strategic intent and objectives.

If a strategy option is not consistent with the organisation's strategic intent and objectives, the organisation has two options. It can either change its strategic intent and objectives, or it can reject the strategy option. If the organisation has carefully considered its strategic intent, and developed it through a consultative process of stakeholder engagement, it will most likely reject a strategy option which is not consistent with the organisation's strategic intent.

8.5.5 Validity

According to Lynch,⁶⁹ validity means that the calculations and other assumptions on which the strategy is based are well grounded and meaningful. These assumptions can be based on valid and relevant business information. However, some of the assumptions may be based on business information that is doubtful in its nature. For example, some of the information Vodacom has about its competitors is firmly based in competitive intelligence and public sources of information, such as the market share data, but some of the information is likely to be more open to question, such as the future plans and strategies of MTN. In practice, there is some overlap between the

considerations for suitability of the strategic option. The organisation's collective experience and business judgements play an integral part in considering the validity and suitability of a strategic option.

8.5.6 Attractiveness to stakeholders

When evaluating a strategic option to determine its attractiveness to stakeholders, the organisation needs to determine if the strategy is appealing to those people that it needs to satisfy. As discussed in [Chapter 2](#), stakeholders include shareholders, employees, the community, suppliers, customers and the government. The stakeholders are interested in the strategic options that are under consideration because they may be affected by them. Because an organisation aims for long-term sustainability, it should consider the impact of potential strategies on stakeholders. It is important to note that stakeholders may not find the strategic options equally attractive, and the organisation may need to prioritise stakeholder claims and interests.

8.6 Summary

As part of the strategic management process, an organisation needs to choose a specific strategy, or combination of strategies, to achieve its overall strategic intent and objectives. Each organisation consists of a unique bundle of resources and capabilities. As such, a strategic option may be appropriate for one organisation in the industry and completely inappropriate for a competing organisation in the same industry.

The chapter commenced with a discussion of the levels of strategies – functional or operational strategies, business level strategies and corporate level strategies. The focus of this chapter is on business level strategies that deal with how the organisation intends to compete in the industry. The business level strategy options discussed in this chapter link in with Porter's original generic strategies. The chapter covered five generic strategic options linked to the source of competitive advantage and the size of the target market. The bases for business level, or competitive, strategies are cost, differentiation and focus:

- The first option is a cost leadership strategy. When an organisation pursues this strategy, it aims to gain a competitive advantage over competitors by maintaining a lower overall cost base. The cost advantage can only be realised if the organisation's product or service appeals to a broad spectrum of customers. The best value strategy seeks to achieve a lower price than that of competitors while trying to maintain a product or service of similar value to that offered by competitors.
- Second, a differentiation strategy where the organisation seeks to provide products or services that are unique or different from those of competitors. The differentiation strategy is viable in markets where the customers are price insensitive.
- With a focus or niche strategy, the organisation develops its competitive advantage by offering products especially developed for the identified niche market. Focus strategies can be either on the basis of low costs (focused cost leadership) or on the basis of differentiation (focused differentiation).
- Finally, an organisation may opt to combine the features of a cost leadership strategy with the features of a differentiation strategy, making it an integrated strategy.

An important implication for strategic managers presented in this chapter is that the appropriate choice of strategy is critical to the success of the organisation. To succeed in building a competitive advantage, an organisation's strategy must aim to provide customers with what they perceive as superior value. This translates into performing activities differently to rivals, and building competencies and resource capabilities that are not readily matched. The organisation needs to evaluate each strategic option. This chapter offered several considerations that an organisation could use to evaluate the strategy such as feasibility, desirability, consistency, validity and attractiveness to stakeholders.

Opening case study questions

1. Explain the levels of strategies and discuss the key differences between them. Explain what business level strategies entail.
2. Identify the business level strategy of FlySafair and explain why the other business level strategies would not have led to the attainment of its mission. What makes the choice of FlySafair business strategy appropriate?
3. Consider the competitive nature of the airline industry and identify the sources of competitive advantage for each operator. Use the criteria for evaluating strategies and comment on the appropriateness of each operators' business level strategies.

Discussion questions

1. Differentiate business level strategy from corporate level strategy.
2. Comment on the strategic management process and when business level strategies are crafted.
3. Provide examples of organisations pursuing the various business level strategies. Justify your answer.
4. Explain how you would evaluate the choice of a strategy in an organisation.
5. Differentiate between the business level strategies and explain why some of them work better in certain kinds of competitive conditions than others.
6. Explain some of the disadvantages associated with each of the business level strategies.
7. Can organisations combine cost leadership and differentiation strategies? Why or why not? Provide examples to strengthen your argument.

Using knowledge and skills

1. Find information on PEP Stores and Mr Price. Compare their strategic directions and business level strategies. Use the criteria to evaluate strategies and then comment on their strategic choices.
2. You are invited to consult on the business level strategy choices in an organisation. The CEO advises that they have identified several possible strategies. You are required to advise them on why it is unwise to pursue too many strategies at once. How would you explain this to them?
3. Use the annual report of three organisations in the same industry and identify the competitive strategies of each one. Find reasons why the different organisations have chosen those specific strategies.
4. Identify the key competitive resources of the Dis-Chem Group, and comment on whether the choice of business level strategy is appropriate.
5. Which of the five business level strategies is your organisation pursuing? What are the strategies employed by your organisation's competitors?

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Suggested websites

Tony Manning Strategy (<http://www.tonymanning.com>) – Competitive strategy and change management

Solution Matrix Limited (<http://www.business-case-analysis.com/business-strategy.html>)

Advanced Competitive Strategies (<http://whatifyourstrategy.com/>) – Publications and examples of the use of competitive strategy simulation

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CHAPTER 9

Strategic innovation

Chris Callaghan

LEARNING OUTCOMES

After reading this chapter, you should be able to:

- relate innovation theories to opportunities for strategic innovation
- explain strategies a manager can use to mitigate and manage the threats of disruptive innovation, while at the same time taking advantage of opportunities that result from it
- discuss how value innovation can be applied to achieve competitive advantage
- compare and contrast red and blue ocean strategies
- explain how to develop a business model
- relate the principles of 'bottom of the pyramid' (BOP) innovation to real-life South African opportunities for innovation
- explain the role of leadership in supporting innovation in an organisation
- discuss the fuzzy front end of innovation and design thinking
- discuss individual characteristics and how to build on individual strengths and mitigate individual weaknesses in building an innovative organisation.

KEY TERMS

ambidexterity theory of leadership
applied design thinking
blue ocean strategy
bottom of the pyramid (BOP) innovation
business model innovation
creative destruction
disruptive innovation
dominant design theory
fuzzy front end of product development
long wave theory
red ocean strategy
technology S-curve
transformational leadership



Blue ocean and value innovation strategies in the hotel industry¹

As of 2018, AccorHotels had 4 300 hotels worldwide, with about 620 000 rooms in 100 countries.² It had 14 438 rooms and 54 hotels in 19 countries on the African continent and a plan for rapid expansion. One of the pillars of the success of this organisation has been the performance of its chain of 'super-budget' Formule 1 hotels. Things were not always this way. Based in France, AccorHotels faced a hotel industry in the 1980s that seemed to be in decline.³ It was in this context that they tried a new way of doing things. The development of Formule 1 was the result of a radically new type of strategy. This type of strategy was identified later by the researchers Kim and Mauborgne from their research of successful organisations in different industries. The strategy is now called value innovation. But key to this strategy was also another approach, whereby it sought to create new and uncontested market space, a strategy Kim and Mauborgne termed 'blue ocean', instead of competing within the existing industry and fighting for the same customers as others, or following a 'red ocean strategy'.⁴

Faced with serious problems of overcapacity and stagnation, the organisation tried an innovative new approach to strategy. Staff were told to not base their new strategy on anything that limited them or to what the industry typically did. This blue ocean strategy sought to avoid competing in red ocean categories, or overcrowded categories with shrinking profit and growth prospects, where accommodation was being commoditised.

Blue oceans are often created by established businesses within their core businesses.⁵ The budget hotel industry offered two service categories; of zero- or one-star hotels that were purely price-driven in their strategy; and two star hotels that offered slightly higher levels of quality. AccorHotels did not limit themselves to the existing assumptions or practices of the budget hotel industry. Instead, they looked for what was common to all the customers of these hotels. AccorHotels framed their strategic approach by looking for:

- services that the industry provided that they felt should be eliminated, such as those that did not add value to customers (these were often found to be the result of unnecessary benchmarking which did not take into account how customer needs were changing)
- services that did not need to meet the industry standards, or that could be reduced below these standards (in many cases, products and services are 'overdesigned' in order to 'beat' the competition)
- factors that needed to be raised above the standards of the industry, such as those that address the compromises that customers in an industry are forced to make
- factors that had never been offered by the industry but that needed to be created in a way that was no longer constrained by the 'boundaries' of the industry.

The Formule 1 model no longer had restaurants and lounges to maintain. Accor believed that these were not justified in terms of the additional value they contributed to customers. The management reasoned that zero- and one-star hotels were offering too much surplus value by using receptionists at all times, and by having closets, dressers and other features. In the Formule 1 model, these were no longer offered. Even receptionist services were only offered at check-in and check-out times. Further, a modular construction process was introduced for the manufacture of the rooms, which allowed for standardisation and quality control. The cost of building these rooms was halved.

Charging a little more than one-star hotels, the value added to customers was more in line with that of two-star hotels. This synthesis of blue ocean and value innovation strategies was a success. Customers got more of what they wanted most and less of what they were prepared to do without. A value curve shows the extent to which the specific features of a service provision align with the existing key success factors for a particular product category or industry. Formule 1 represented the creation of a new value curve; more value was offered

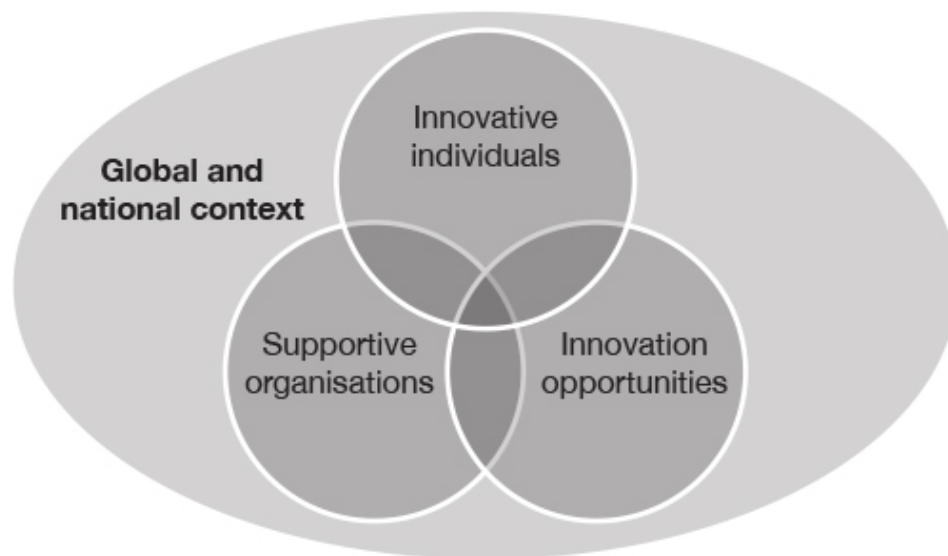
to customers in terms of hygiene, bed quality and other value attributes, which they really wanted. Less value was offered in other areas. In other words, AccorHotels challenged the value curve of the industry by changing the areas of their service provision.

AccorHotels did not let their competitors lead in setting the parameters of their strategy. Instead, rather than compete on the strengths and weaknesses of their competitors, AccorHotels changed the game itself by changing their value curve. By making the competition irrelevant, AccorHotels was applying a principle of blue ocean strategy. AccorHotels did what seemed to be the unthinkable; instead of growing their customer base through more specific segmentation according to customer differences, they looked for what was common across customers and their needs. Instead of limiting their strategic options to their existing assets and capabilities, they took a fresh look at their options. This included the option of starting from a clean slate in terms of their strategy. AccorHotels also did not limit their strategic thinking to offering the types of goods and services that other hotels were offering. Neither did they follow industry definitions of what should or should not be offered. By applying a synthesis, or a mixture of blue ocean and value innovation strategies, AccorHotels was able to turn a difficult situation into an opportunity.

Overview

The case of Formule 1 provides certain lessons for how to apply value innovation, and how to create new blue ocean markets without going 'head to head' with established competitors or ending up in a **red ocean**. In developing contexts like South Africa, large and typically untapped markets exist. It is in these contexts that bottom of the pyramid (BOP) innovation can be extremely rewarding. These opportunities do not exist in isolation, however, and need to be understood within the innovation context. Innovation within organisations, or organisational innovation, is dependent on the interactions between innovative individuals, a supportive organisation and innovation opportunities. These elements exist within a global and national context that influences innovation in organisations.

Figure 9.1 The innovation context and its constituent elements



In [Figure 9.1](#) the components of the innovation context, namely innovative individuals, supportive organisations and innovation opportunities, are located within the overarching global and national context. The relationships shown in [Figure 9.1](#) are used as an organising framework for this chapter. First, [section 9.1](#) provides a brief introduction to the chapter. Next, innovation opportunities are introduced in [section 9.2](#). An important source of opportunities in the South African or any other context is knowledge of the theories of innovation, and the chapter starts off with an overview of certain of these theories in [section 9.2.1](#). Next, innovation opportunities associated with value innovation ([section 9.2.2](#)) and blue ocean strategies ([section 9.2.3](#)) are explored, with a focus on the innovation opportunities

they present for achieving competitive advantage. Business model innovation (section 9.2.4) and bottom of the pyramid innovation (section 9.2.5) are then considered in terms of the opportunities they offer.

Section 9.3 introduces and discusses the importance of ensuring supportive organisations for the success of innovation in organisational contexts. The role of leadership (section 9.3.1) is considered as an important contributor to organisational innovativeness through its contribution to enabling a supportive organisation. Key activities and roles involved in setting up and maintaining processes of innovation (section 9.3.2) are then introduced, with specific reference to increasingly important topics in the strategic innovation field, namely the fuzzy front end of innovation and design thinking. This discussion caps off the supportive organisations section of the chapter. This section provides you with an important management 'toolbox' of useful ideas for how you can improve organisational innovativeness through developing an organisation supportive of innovation.

Finally, the topic of innovative individuals is introduced (section 9.10). In this section, certain theories are explored that predict the characteristics of innovative employees in the workplace, with the rationale that knowledge of these differences may help you as a manager to build on the unique strengths of staff as well as to be aware of individual differences so as to be able to empower and build on these as well.

9.1 Introduction

The achievement of sustainable growth, or growth in above-average returns, is challenging. This is particularly so in a globalised context of increasing uncertainty and global competition. Any competitive advantage at a point in time is, by definition, temporary. Nevertheless, continuous improvement is necessary in order to survive and to prosper. This is the natural order of things, whether in South Africa or anywhere else. Natural limits in the way things are done, or in the technologies that organisations use, impose constraints, or barriers, to continuous improvement. Innovation, or doing new and different things, can in such cases become more important than simple improvement, or doing the same things more efficiently. As shown in the Opening case study, *Blue ocean and value innovation strategies in the hotel industry*, value innovation, as a form of **strategic innovation**, can be used to create new markets, and in doing so, one can create **blue oceans**, or uncontested market spaces where the competitors are made irrelevant.⁶ There are countless opportunities available to an organisation, but these need to be recognised. This chapter will seek to help you to do this. To be able to apply blue ocean or other innovative strategies, managers need to have a grounding in the principles of innovation itself. Another name for these principles is theory. Innovation theory is a set of principles that explain how things work in the real-world context of applied innovation. A theory can be seen as a roadmap, or a key to unlocking the potential of an innovation opportunity.

A sound knowledge of innovation theory is therefore important for every strategic manager who has to apply the principles of innovation in a business. To seize innovation opportunities, it is important to be able to apply knowledge of the threats of **disruptive innovation**, whether to use this to your advantage as a disruptor, or to protect yourself from disruption. Disruptive innovation relates to new ways of doing things (innovation) that can create a new market and value network, which displaces, or disrupts, an existing one. Innovation has been found to exhibit patterns in how it changes over time, and in the way it occurs or behaves. For example, Schumpeter's theory of **creative destruction** suggests that disruptions are to be expected (as the rule rather than the exception). Foster's **technology S-curve** explanations offer useful insights into how to avoid being disrupted by new technologies, and what strategies you can employ to counter the effects of technological disruption. Insights into human behaviour show us that under certain conditions people can reject innovations even when there is clear evidence that they work, as shown by the Semmelweis innovation paradox. Markets can also change as they begin to accept a certain standard (as it was with the adoption of the format of the QWERTY typewriter). Organisational learning can also be a form of innovative competitive advantage, whereby if an organisation stops investing in its accumulation of absorptive capacity, it can fall behind its competitors. Absorptive capacity is the ability of an organisation to identify valuable information, and to harness it and bring it into the organisation to use profitably. By investing in its ability to absorb information and knowledge, an organisation can gain a competitive advantage over its competitors. The

section that follows takes you on a journey of learning that brings together these topics, offering a holistic perspective of how a manager can use and apply this knowledge to obtain a competitive advantage in the South African real-world business context.

In a world in which technology is able to more frequently disrupt business models, it is important to understand both the dangers and opportunities associated with disruptive innovation. There is no substitute for a good grounding in innovation theory. This is because theory provides you with predictions about what can happen to your business under different conditions. It also gives you important principles that can be useful to guide your decision-making. Kondratiev's **long wave theory** of innovation is helpful to understand how innovation changes in its effects over time as opposed to how the business cycle occurs. Schumpeter's theory of creative destruction provides a realistic view of how organisations continually face a process of creative destruction or changes in the economic structure itself. It is important to realise how vital knowledge of strategic innovation is to survive in turbulent conditions, and Schumpeter's ideas help to focus our attention on this. Foster's warnings about the dangers of disruptive innovation provide useful knowledge about how to map your organisation onto the technology S-curve and how to deal with the threat of technological disruption. It is important, however, to keep in mind findings that show that people can resist innovations. An example of this is the Semmelweis Effect, which will be discussed in the chapter. An understanding of **dominant design theory** is also important, because market structure can change when industry standards become accepted, and the 'rules of the game' change. An organisation can be caught unawares if not prepared for such changes, and needs to be able to manage external and internal knowledge, and continually increase its absorptive capacity to enhance its innovative capabilities.

As stressed in the Opening case study, two extremely important channels through which you can pursue innovative opportunities are through the application of principles of value innovation and blue ocean strategies. Competing in industries or market segments that are overcrowded is problematic, and this is particularly so when commodification is increasing, or where products become undifferentiated, and the only way to compete is on price. In this way, 'red oceans' emerge. A **red ocean strategy** relates to highly contested market space. For example, when a business competes on price, it will go head to head with pre-existing competitors, and the competition can be damaging to everyone involved, but one can avoid this by applying a **blue ocean strategy**. By doing so, new sources of competitive advantage are created. Market share strategies that are about today's issues (such as decisions about what marketing mix to use, or other tactical decisions that are aimed at increasing the organisation's share in markets that already exist), are not enough. Tomorrow's issues are also important, and market creation, or the development of new markets, also needs to occur. Market creation not only 'changes the game'; it creates a new one, because it can make existing competitors irrelevant.

The engine of your business strategy can be your use of business model innovation to set you apart in the market. South African organisations like Discovery Health have used **business model innovation** to redefine the nature of their business, and now compete on the international stage. As a strategic manager, you will need to apply the principles you learn in this chapter in the real-world context. In South Africa, substantial opportunities exist for **bottom of the pyramid (BOP) innovation**, or innovation that uses certain principles of business model innovation to target a huge and untapped market of low-earning customers and providing for their needs more effectively and cost efficiently than the way existing products can. In the South African context, application of BOP innovation strategies can offer an organisation important opportunities to enhance competitive advantage. In order to be able to seize innovative opportunities, a supportive organisation needs to exist. Developing and maintaining an organisation that can convert innovation opportunities to competitive advantage is a complex task, and key to making this happen is leadership.

All the tools and techniques needed to capture innovative activities need to be complemented by a leadership approach that maintains a constant state of innovativeness within an organisation. Two leadership theories stand out in the way they provide useful principles for strategic managers who need to maintain innovativeness. The first is the **ambidexterity theory of leadership**, which differentiates between exploration (seeking new ideas) and exploitation (implementation) behaviours. Both of these behaviours are forms of organisational learning. Knowledge of

ambidexterity theory helps to focus managers on enhancing the quality of exploration behaviour of individuals to improve innovativeness. The second is **transformational leadership** theory, which offers useful principles a strategic manager can use to motivate staff to achieve visionary goals related to change and innovation through increasing their motivation, understanding and self-worth.

Leadership is not enough, however, to ensure an organisation maintains its innovativeness. One also needs to understand how to set up and maintain processes of innovations within the organisation. It is therefore important to understand how to begin the innovation process, and knowledge of the principles of the phase known as the **fuzzy front end of product development** is useful, particularly because this phase is so different from those that follow it in the development process. Similarly, there are very useful ideas that have emerged in other fields that are now increasingly being applied in strategic innovation practice. An important example of this is found in **applied design thinking**, which applies the methods and mindsets that have resulted in successful design in fields like engineering, industrial design and architecture. Using these principles it is possible to design products based on a deep understanding of the customer, while using the talents of staff through collaboration.

The chapter concludes with a consideration of individual innovativeness. It is through the efforts of individuals that you will need to achieve organisational goals, and this section gives you an overview of personality and individual values theory. Knowledge of individual strengths and weaknesses is important, so that strengths can be built on and weaknesses can be improved. Only through knowledge of one's strengths and weaknesses can one improve.

By taking you through these topics, this chapter seeks to offer you a useful 'learning journey' that will give you conceptual tools, techniques and principles that you can apply in the real-world context. To benefit fully from this important knowledge, you will need to constantly think of how you would apply this knowledge critically in the real-life context. A critical approach is necessary in strategy because under different conditions you will have to make different decisions.

9.2 Innovation opportunities

9.2.1 Innovation opportunities presented by innovation theories

Theories can help one to derive practical implications and predictions. This is particularly important with regard to recognising disruptive innovation and the use of these predictions as an aid to managing it. A failure to manage disruptive innovation using strategic innovation can result in the potential disruption or destruction of markets and the failure of the **organisation**. As discussed, a disruptive innovation is an innovation that creates a new market, and changes the way a market or industry functions. An example is the cellphone, which has had a game-changing influence on telecommunication markets.

Why is knowledge of disruptive innovation important? Risky choices are made all the time in strategic management. Risk, however, can be quantified or calculated.⁷ Using probabilities, it is possible to estimate the chances of different outcomes occurring. Uncertainty, on the other hand, relates to conditions where no estimates can be made of different outcomes occurring. Disruptive innovation is associated with uncertainty. Worryingly, people are found to be less sensitive to uncertainty than to risk. For example, managers can manage risk (as it can be measured), but decisions are often made when risk is confused with uncertainty. It is always important to try to quantify the risks associated with decision-making in a business. Businesses typically avoid uncertainty as they cannot accurately estimate its consequences. The business still needs to be managed, however, even in the face of uncertainties that, unlike risks, cannot be estimated or calculated. A strategic manager needs to also be sensitive to the potential of disruptive innovation to destroy markets. With no real way of measuring or estimating the probabilities involved in managing potential disruptive innovation, knowledge of theory can be useful as it provides knowledge with regard to how to manage this uncertainty.

Whereas the focus of value innovation is the development of new markets and the creation of new value for customers, disruptive innovation is the way in which innovations can change how competition occurs in an industry, and how value is lost by incumbent organisations. According to Markides, although it is primarily new business models that disrupt markets,⁸ they can use technology and changes in technology to do so. Christensen initially argued that disruptive technologies were the cause of the disruption of markets, but then turned his focus to the role of business models in the process, and coined the term ‘disruptive innovation.’⁹ Theory that relates to the role of technology in disruptive innovation can be used to provide insight into strategic innovation decisions. A theory can be taken to be an explanation of the way things relate to each other in the real world. Strategic management, whether facing risky or uncertain conditions, requires practical or applied actions, and knowledge of the predictions of theory can help to guide such actions.

9.2.1.1 Theories of innovation

This section provides an overview of certain seminal theories that offer an understanding of how markets can be disrupted. A seminal theory is typically an important theory that has changed the way in which a field is studied. In light of the need to use theory as a guide to change, [section 9.2.1.2](#) introduces Kondratiev’s long wave theory of innovation, which can offer useful insights into how innovation opportunities can change over time. Kondratiev’s theory provides an overview of the role of technological change, which is closely related to innovation-based change. This theory provides predictions of how technology changes over time. [Section 9.2.1.3](#) presents Schumpeter’s theory of creative destruction. Schumpeter argued that the destruction of markets is not unusual, but is a natural part of market systems. Strategic innovation is therefore an important aspect of strategic management, as it is necessary to deal with the forces of disruption.

Foster’s technology S-curve theory is introduced in [section 9.2.1.4](#). The technology S-curve can be used to predict when a technology can no longer deliver value to customers, and when disruptive innovation in its markets can be expected. When organisations enter new markets, competitors typically follow. Knowing how to plot an organisation on its technology S-curve is a useful technique when new technologies can disrupt markets. [Section 9.2.1.5](#) provides a discussion of dominant design theory. A dominant design, or standard type of product offering, typically emerges in new markets. **Dominant design theory** offers insight and predictions that help us understand how this process occurs in certain industries. The way that knowledge is used in strategic innovation is also critically important. Finally, [section 9.2.1.6](#) closes the section on theories of innovation with a review of absorptive capacity theory, which provides a perspective of how information and knowledge can be harnessed within an organisation. This theory is particularly important in a world in which knowledge is a factor of production and can provide competitive advantage. Having derived practical predictions for strategic innovation in conditions of uncertainty from these theories, the next section looks at how disruptive innovation occurs in business contexts.

9.2.1.2 Kondratiev’s long wave theory of innovation

A study of the history of innovation reveals that innovation does not typically happen in a consistent way.¹⁰ Innovations typically ‘group together’ at the end or start of long wave cycles. Kondratiev long wave cycles relate to how economic activity (prices and interest rates) change over time. By understanding how these cycles may behave, a manager can use these insights for decision-making. The large-scale innovations associated with the internet boom in the 1990s are similar to other periods of large-scale innovation. High levels of innovation typically disrupt incumbent or existing industries. Business cycles seldom extend beyond a decade. In contrast, according to Kondratiev, innovation cycles typically follow a 50-year cycle.¹¹ Since the Industrial Revolution, there have been five 50-year Kondratiev cycles, each of which has been associated with a different technology: (1) a cycle associated with cotton, iron and water power; (2) a cycle associated with railways and steam power; (3) a cycle associated with electricity, chemicals and steel; (4) a cycle associated with automobiles, electronics, oil and aerospace; and (5) a cycle

associated with computers, telecommunications and the internet. According to Kondratiev, each long wave of innovation generally follows four stages.

- The first stage is the recovery phase where economic activity starts to increase.
- In the second phase, the prosperity stage, economic activity rises to its peak.
- In the third phase, the recession phase, economic activity begins to drop off.
- In the fourth phase, the depression phase, economic activity drops to very low levels.

It is at the peak of the prosperity phase that speculative 'booms' can occur, which typically end with some sort of crash in markets, leading to the recession and depression phases.

Surplus capacity and diminishing returns create the conditions for phase three – the recession phase. Price competition can begin to dominate in the recession phase, as the limits of the technology are approached. In this phase the focus of innovations changes, moving away from new products and toward process innovations, which increase productivity. However, in the depression phase, market saturation and price competition become increasingly intense and profits decline. In response to these conditions, mergers and acquisitions may increase as consolidation occurs. Certain predictions of long wave theory apply to disruptive innovation:

- Changes in long wave cycles can result in disruptive innovation on a large scale. These disruptions can occur across the different markets that are associated with a particular technology.
- Radical innovations typically occur at the start of new long wave cycles; as the conditions for their creation tend to arise at the end of the previous cycle.
- Long wave cycles can have an influence on the economic and social system, and institutional changes in education and training, industrial relations, corporate structures, management systems, capital markets and legal systems can result.¹²

Kondratiev's long wave cycle theory can be used as a framework to analyse an organisation's markets and to place it in relation to potential long-term changes. If you can 'map' an organisation or an industry in relation to long wave cycles, then you will be better prepared for such large-scale changes. Schumpeter used Kondratiev's long wave theory as a basis for his work on the destruction of markets, and it was from this work that Schumpeter's theory of creative destruction emerged.

9.2.1.3 Schumpeter's theory of creative destruction

According to Schumpeter, the market system, by naturally growing developing economies at rates of at least 2% per year, can eliminate poverty.¹³ Schumpeter stresses that uncertainty, however, is an inherent aspect of these systems. Organisations face a process of 'creative destruction', or a process of 'industrial mutation...that incessantly revolutionises the economic structure from within, incessantly destroying the old one, incessantly creating a new one.'¹⁴ Similarly, 'revolutions periodically reshape the existing structure of industry by introducing new methods of production.'¹⁵ The market system is therefore 'never stationary' as it keeps re-organising itself.¹⁶ What this means in simple terms is that businesses will face a process of creative destruction where many will fail and others will succeed. The resources of failed businesses then get channelled back into the system, and the system (of markets) itself changes, or is continually revolutionised. This reorganisation, however, results in growth and is for the benefit of society. Therefore, for Schumpeter, '[e]very piece of business strategy acquires its true significance only against the backdrop' of creative destruction.¹⁷ Strategy therefore must 'be seen in its role in the perennial gale of creative destruction: it cannot be understood irrespective of it.'¹⁸ What Schumpeter means here is that all strategy needs to take into account the dynamic nature of the market system, which is inherently a system in which many businesses fail, and that one cannot assume that a business will not be subjected to these winds of change, or gales of creative destruction. While society benefits from the more efficient production of goods and services (what you buy tends to

get cheaper and better over time due to competition), the strategic management of a business needs to be able to take into account disruptive innovation in order to survive. Society benefits from creative destruction through the innovations it produces that keep offering improvements in value to customers.

The Industrial Revolution changed production and society, as a fundamental change in the economics of production occurred. Adam Smith's notion of the 'division of labour' had revolutionary results.¹⁹ An example of the division of labour, given by Smith, is of pin makers. Whereas 10 pin makers could make a certain number of pins each if they worked alone, when the tasks are split up between them a great deal more can be made. In Smith's own words, '[t]he greatest improvement in the productive powers of labour, and the greater part of the skill, dexterity, and judgement with which it is anywhere directed, or applied, seem to have been the effects of the division of labour.'²⁰ The Industrial Revolution fundamentally restructured not only productive capacity, but also society. Different value curves were made possible. Many industries also faced 'creative destruction'. If such changes can be viewed as strategic opportunities, and if change is expected, then organisations might be better prepared for them.

Indeed, other revolutions have also happened, and are happening, which support Schumpeter's predictions of how creative destruction can result in societal benefits, even if old ways of doing things were made obsolete and certain firms went out of business. The knowledge revolution, caused by the advent of the personal computer and the internet, is another revolution that offers us a useful example of how society has benefited from creative destruction.²¹ Before the knowledge revolution, organisations could only produce according to calculations of where marginal cost met marginal revenue; the 'marginal principle'. For example, if R1 000 spent on marketing a product resulted in R10 000 in profit over a period, then for the next period another R1 000 would be allocated. The R1 000 spent in the next period might only bring in R5 000, but this process would be continued until the R1 000 spent brought back only R1 000. However, the knowledge revolution has changed the underlying economics of production for certain industries. There is no longer a marginal cost to send one software package or one digital music album to a customer via the internet. This change in the underlying economics faced by industries is playing itself out in organisations and in societies every day. As Schumpeter predicted, more revolutions are coming. Three-dimensional (3D) manufacturing, or printing, is a way that goods can be manufactured by machines.²² In fact, as discussed in the Strategy in action case below, some suggest that 3D printers will even be able to 'print' human organs one day. As Schumpeter stresses, 'every piece of strategy' is only effective against an understanding of the backdrop of creative destruction.

STRATEGY IN ACTION: The case of 3D manufacturing²³



Three-dimensional (3D) manufacturing, or additive manufacturing, might have the potential to introduce disruptive innovation on a global scale. Body parts such as bone replacements and dental implants are already being made, and some suggest that human organs may one day also be 'printed' using this technology. Less wastage occurs – using conventional manufacturing, up to 90% of materials can be wasted in the process. This process uses computer-aided design to print 3D objects, layer by layer, until the object is ready. Off-the-shelf 3D printers are now available, and software can be used to manufacture items. The size of these machines is also increasing, and larger components for aerospace industries are being produced. Conventional, or subtractive, manufacturing faces a challenge from this form of additive manufacturing. Logistics and supply chains face a revolution. Established markets and incumbent industries may face the prospect of disruptive innovation on a large scale.

Questions

1. Can you think of new value curves that can be developed for organisations based on this new technology?
2. Can you think of markets that will face potential destruction, or disruption, based on the impact of this new technology?

3. Explain how Kondratiev's predictions may relate to the impact of this new technology.
4. Analyse Schumpeter's predictions in relation to the global influence of this new technology.
5. At the moment, China might be seen to dominate world trade in exports.
 - What do you think would happen to world trade if 3D manufacturing eventually replaced conventional manufacturing?
 - How do you think these changes would affect businesses in South Africa?
 - How might this affect the strategic management of South African organisations; particularly in terms of their supply chains?

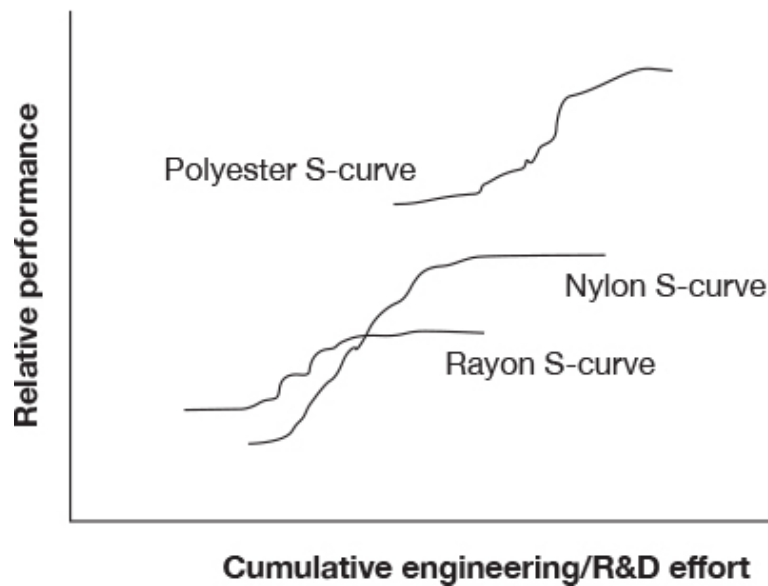
9.2.1.4 The technology S-curve and disruptive innovation

According to Foster, when changes in technology occur, industry leadership can change hands.²⁴ These changes, however, follow a pattern. According to Foster, every technology has a limit, which can be represented by an S-curve, which represents the performance of the technology over the engineering, or research and development (R&D) investments made in the technology.²⁵ Typically there is a 'natural limit' associated with a technology. For example, a silicon chip can hold only a finite amount of information, and is limited by the amount of heat that is generated in the process. This is a constraint eventually experienced by Moore's law. Moore's law predicts that integrated circuits will have about double the components every two years.²⁶ Although Moore's law has predicted technological advancements in this area for a number of years now, the natural limits of a certain process will ultimately be expected to halt these advances unless a new technology can emerge.

The potential performance of a technology is termed its 'technical potential'.²⁷ If an organisation is able to find out where the limits of their technologies are, the payoff can be significant. IBM, for example, evaluated the limits of their computer technology, and discovered that the design of the chip package was an important one. They were able to change the design, and this helped them to continue to dominate in their markets. It is inevitable, according to Foster, that the technology with the most potential will end up dominating the market. Changes in the dominance of a technology are therefore usually associated with changes in the leadership of the industry. The return on R&D is key to achieving market leadership.

How can S-curve theory be used to obtain a competitive advantage? The point at which the existing technology reaches maturity is termed the inflection point. Strategic managers need to be proactive and be able to map the technologies that are used by the organisation, which can act as an 'early warning' system. The approaching maturity of a technology that might lead to a new radical innovation or to a successor technology might be detected this way. If a new successor technology can be identified and developed, this can lead to competitive advantage. However, if an organisation fails to identify and anticipate new technologies, it can itself fail. Organisations should also not limit their R&D to developing just one technology, because this would limit the progress of technologies to just one S-curve.

Figure 9.2 S-curves of the performance of materials used in tyre manufacture²⁸



In Figure 9.2, the S-curves reflect the changes in the tyre industry caused by the adoption of different materials in tyre manufacturing. Rayon initially promised more potential than nylon, but diminishing returns set in before they did for nylon.²⁹ Nylon then also realised diminishing returns and reached its natural limit. A radical innovation entered the market in the form of polyester. This radical innovation was able to provide higher levels of performance and dominated the market. Discontinuous innovation occurs when a new technology has reached the point at which it produces higher performance than the 'old' technology for the same cumulative engineering effort and when the new technology replaces the old. This is called 'discontinuous' because there has been an end to the continuity associated with the use of the old technology.

As can be seen in Figure 9.2, the S-curve has an S-shape, as diminishing returns to investments are shown as an S-shape over the curve. Increases in engineering effort are seen to result in diminishing marginal performance over time. This means that although initial increases in engineering effort produce increasing performance, this does not continue, as over time more engineering effort produces less and less performance per unit of effort. Technical discontinuities, or changes in a market (such as the emergence of a competing technology), are, however, often not discovered in time because organisations have different incentives.³⁰ An incumbent organisation (an existing business) has a lot to lose if its technology is replaced by another one introduced by a competitor, yet organisations introducing a new technology may have less to lose by innovating more aggressively. Incumbent organisations can, however, be so committed to their technology that they do not acknowledge that competitor technologies are a threat. They might be overconfident, or they might not notice the new technology introduced by their competitors before it is too late. Foster describes the failure of a business to identify (see) the threat posed by another technology as 'technological blindness'.³¹

According to Foster, this 'blindness' to the advantages of other technologies has had a significant effect on 'almost all industries at one time or other'.³² Examples of how new technologies introduced by competitors disrupted technologies used by incumbent firms can be found in the electronics industry. In this industry, vacuum tubes were replaced by transistors, which were, in turn, replaced by microprocessors. Another example is the use of two-piece cans to replace three-piece cans in the metal packaging industry. In each case, these changes in technology resulted in changes in the leadership of the industry.

A way of avoiding the consequences of discontinuous innovation and market destruction associated with radical innovation is to be able to manage the transition to new technologies that have more potential; to 'cross discontinuities' effectively.³³ Whereas the continuity of the old technology is disrupted when the new technology

takes over (and discontinuous innovation then occurs), being able to cross discontinuities refers to the ability to manage the transition from the old technology to the new. As a strategic manager it is important to be able to identify and ensure that your organisation can cross discontinuities effectively. Being able to make the change between technologies represents a technical strategy. Foster considers certain strategic errors to generally be the cause of organisation's market losses in the face of technological changes. These are 'technological myopia', the misreading of market signals, and the 'culture trap'.³⁴

- *Technological myopia*: Myopia means short-sightedness. In order to avoid technological myopia, Foster recommends shifting the focus of R&D further out. Many new technologies can be foreseen. A technical strategy of defending a technology can fail, which can simply lead to the new technology being developed unchallenged. An example of this is sail technology. When steamships emerged as a challenge to sailing ships, the sailing ship industry chose to defend the technology; it invested in more efficient improvements to sail power, yet these were to no avail – steamships replaced sail technology despite all their efforts. They were short-sighted, and did not realise that the technology had reached its natural limit. This strategic error can, however, be remedied by surveillance of emerging technologies.
- *Misreading market signals*: Organisations often miss out on the information that the market provides about a new technology. This can occur because new technologies are often introduced in niche markets, and are more difficult for incumbents to see. In growing markets, incumbents often misinterpret a levelling off in sales in a market as a sign of market maturity instead of technology substitution, or the advent of a new technology. Misreading market signals is related to the problem of defining a market, according to Foster. Any new product, and especially one that is related to a new technology, essentially redefines a market. A strategic mistake in misreading market signals is to assume that an organisation has the luxury to wait for market research cues before allocating resources or funds to a new technology.
- *The culture trap*: For Foster, cultural weaknesses are the most serious constraints to the strategic management of technological innovation. Choices of products and production methods, and the technology used in production, are a function of an organisation's corporate culture. In fact, the technology that an organisation uses shapes other strategic choices an organisation can make when opportunities are encountered. Therefore, when the technology changes, the entire corporate culture may have to change. This is an extremely difficult process. According to Foster, the change from vacuum tubes to solid-state technology forced a new culture on organisations in the industry; engineers, for example, needed to understand a new field of mathematics. Cultural resistance to change can make it very difficult to change to a new technology. New skills are needed, and new recruits into the organisation might come from different academic and commercial fields. Changes in shared values and management style are needed. In order for a manager to manage strategic innovation, knowledge of how to manage culture is therefore critically important.

Having considered S-curve theory and how it can help one to understand when disruptive innovation can occur, and how to try to avoid it, the challenges associated with surviving in a new industry are now explored.

9.2.1.5 Dominant design theory

Dominant design theory, according to Suarez and Utterback, addresses certain reasons why some organisations do not survive in innovative environments.³⁵ This theory was developed in the context of assembly manufacturing industries. Apple, Samsung, Sony and Nokia are examples of organisations in these industries. The emergence of a dominant design in such an industry can dictate the survival or failure of organisations. A dominant design is a specific path according to which an industry develops, that is influenced by technical and market factors, and which achieves acceptance in a market over other competing designs.

A dominant design is reached through the management of technological, economic and organisational factors.³⁶ A dominant design forces a standard on a market. Such standardisation typically allows economies of scale to

develop. This fundamentally changes the industry because cost, as well as product performance, can then become the basis for competition between organisations. The emergence of a dominant design therefore marks a transition point, or milestone, in an industry's life cycle.

Because the survival of an organisation is influenced by the density of an industry, or how many organisations are in the industry, and because the density of an industry is in turn dependent on the technology life cycle of an industry, the survival of organisations is also related to the technology life cycle of an industry.³⁷ Before stakeholders settle on a specific dominant design, there are likely to be many different competing designs in an industry. When a dominant design emerges, the competencies required for survival will usually change, as those organisations that can produce by taking advantage of economies of scale will tend to survive. The emergence of a dominant design changes the rules of the game.

A dominant design can comprise a set of standards that are related to each other.³⁸ An industry standard is usually formed when one standard is accepted in a market over other standards. Usually this occurs after a battle between competing technical alternatives. Examples of industry standards are Blu-Ray and the compact disc, which achieved market acceptance after intense competition with other alternatives. Dominant designs act as industry standards, and can develop when certain of the following conditions exist:³⁹

- *The presence of collateral assets:* Collateral assets are assets that offer an organisation advantages like market channels, brand image or other factors that make it more difficult for a customer to switch to a competitor. If an organisation has these, then it is easier to achieve a dominant design. The value of these collateral assets will typically increase after the dominant design is accepted by the market.
- *The influence of government regulation or intervention:* Governments can approve a standard, and can influence the acceptance of standards through regulation. Government purchases at the early stages of the industry can also support the development of standards. An example of government intervention was the case of the US government's acceptance of RCA's broadcast standard, which became the dominant standard in broadcasting because of this.
- *Strategic actions taken at the organisation level:* The application of strategy can be the difference between failure and success in a standards war. An example of the impact of strategy on the battle for an industry standard is the case of the clash between NC's VHS and Sony's Betamax video standards. NC used alliances and contracts to deepen their network of sales, but Sony avoided this by trying to produce in-house in order to capture a greater share of the profits. However, Sony lost out when the market adopted VHS due to its deeper market penetration. The lesson here, according to Suarez and Utterback, is that it was the strategy applied by NC that 'won' the standards war, and not collateral assets, government intervention or technological advantages that contributed to this decisive victory.
- *Bandwagon effects or network externalities in the industry:* Generally, when an industry standard develops then economies of scale become very important. Why? Because of the stability that follows the emergence of the standard. Bandwagon effects, or network externalities (benefits that are related to networks, or groups of people that are interconnected), occur when a product or service is more valuable to a customer the more that others also buy the product or service. An example here is the way Facebook has become more valuable as more people have joined the platform, as the benefit to someone increases as more acquaintances come on board.

What actions can an organisation take to establish a dominant design? An organisation can test different features of the design using different products in different niches.⁴⁰ A dominant design can also be developed from different technological innovations in a cumulative way. Suarez and Utterback give the example of the dominant design of the typewriter. Earlier designs used only capital letters, but slowly incorporated different features such as having a shift key that could use both lower case and capital letters. Further innovations allowed the operator to see the paper being typed, unlike earlier models. Innovation in this case followed a trial-and-error, or experimental, process. The dominant design of the typewriter eventually emerged in 1909, in the form of the Underwood Model 5 typewriter.

Suarez and Utterback also stress that in industries such as assembly manufacturing, the later an organisation enters the industry after a dominant design has emerged, the greater the chance that the organisation will not survive.⁴¹ The reason for this is the erection of industry barriers. Entry barriers are erected by organisations that have successfully mastered the new design and that now are able to build up collateral assets while developing economies of scale. According to Suarez and Utterback, organisations should enter markets as early as possible in order to experiment in them and try to come up with the dominant design. As stressed by Foster, knowledge is at the heart of an organisation's ability to successfully manage innovation. Absorptive capacity theory offers important insights into how knowledge can be used for strategic innovation.

CASE EXAMPLE: South Africa and its role in relation to 'exponential technologies'⁴² and the 'Fourth Industrial Revolution'⁴³

As a student of strategic management you may ask: 'Why is strategic innovation so critically important and why are so many people increasingly interested in it?' And particularly: 'Why is it so important in South Africa at this time?'

According to the World Economic Forum Global Competitiveness report,⁴⁴ in 2012 South Africa was rated as 140th out of 144 countries, or fifth lowest in the world, for the quality of its education system. In stark contrast, according to the same survey, the country was ranked 15th best in the world for the quality of its business schools; 41st for its capacity for innovation; 34th for the quality of its research institutions; 30th for university–industry collaboration in R&D; and 37th for patent applications weighted per population size. There seems to be a big contrast between these rankings. The country has one of the world's worst-rated education systems, yet it is rated as being one of the best countries in the world in innovativeness? Innovativeness has an important relationship with exponential technologies, which are technologies that can have very high societal impacts. They are called exponential because their impacts can be curvilinear (exponential) when plotted on a graph. South Africa needs to ensure that it is well placed to take advantage of the rise of the exponential technologies (education is the primary driver of a country's knowledge capacity), or it might be left behind. As predicted by absorptive capacity theory, once left behind it is difficult to catch up. The country stands at the brink of a revolution in technologies, which it needs to be ready to take advantage of. This revolution is in the area of exponential technologies.

For the period 2017/2018,⁴⁵ South Africa's national competitiveness, or the indexed measure of the 'set of institutions, policies and factors that determine [its] level of productivity' placed it 61 in the world (down from 47th in the previous year period) out of 137 countries, and with one of the highest levels of income inequality in the world. The five most problematic factors for doing business in the country were identified as inefficient government bureaucracy (5th), high tax rates (4th), government instability (3rd), crime (2nd) and corruption (1st). An inadequately educated workforce was 8th on this list.

In order to provide employment and to solve societal problems, the strategic management of the exponential technologies is critically important for South Africa. On a worldwide basis, 'knowledge has replaced the traditional assets of land, capital, labour, and entrepreneurship as a basis for competitive advantage.'⁴⁶ To achieve innovation as a country, a strong education system is needed. Strategic innovation is a critically important field as technological advances are increasingly changing markets and creating new ones. Rapid developments in medicine, robotics, artificial intelligence, synthetic biology, 3D printing and nanomaterials (engineering at a very small level) are occurring at an exponential rate.⁴⁷ The price of these technologies is also decreasing, as they become more powerful. New value curves, business models and markets will follow. Societal problems will be solved in areas such as energy, health education, and security. Smaller businesses will be able to do what in the past only very large organisations could. This is the era of 'exponential technologies'. As a strategic manager, it is important that you are able to apply the principles of strategic innovation to any opportunities that you identify. Technological opportunities are an important source of competitive advantage that can help local organisations to challenge world leaders.

STRATEGY IN ACTION: The innovation paradox⁴⁸



In 1847, Ignaz Semmelweis discovered how to dramatically reduce the mortality rate in the maternity ward in which he worked.⁴⁹ At that time doctors used to perform surgery without washing their hands. Semmelweis had the staff wash their hands in a solution of chlorinated lime. Despite the dramatic drop in the mortality rate, and despite clear evidence of the success of his innovation, his peers rejected his methods. After he left, things went back to how they were before. This is an example of the 'Semmelweis effect', or 'innovation paradox'. Another example is the QWERTY keyboard.⁵⁰ Before typewriters were electronic, they were mechanical. If someone typed too fast, keys used to stick together. To avoid this, the designers had to come up with a keyboard that would slow human typing down, which required the more awkward key strokes. It worked. However, now that electronic keyboards have been with us for quite a while (and alternative keyboards, such as the Dvorak, are available), the QWERTY keyboard remains the dominant design, or the form of keyboard that is still extensively used. Knowledge of the innovation paradox is important in strategic innovation, because it can help one to be aware of resistance to change. Often, people will resist innovations and change, even if there is clear evidence of the benefits of such innovation. Knowledge of the innovation paradox might help you to develop a dominant design.

Questions

1. Relate the predictions of dominant design theory to the innovation paradox.
2. How do you think you can use your knowledge of the innovation paradox to achieve competitive advantage?

9.2.1.6 Absorptive capacity

According to Cohen and Levinthal, successful innovation depends on the ability of an organisation to notice the value of external information that is new, to incorporate it and apply it to commercial goals; a capability termed 'absorptive capacity'.⁵¹ Much evidence shows that external sources of innovation are usually critically important for innovation, but often under-utilised. External sources include those outside the organisation or from other sources within the organisation but outside the R&D unit. However, the use of this knowledge is dependent on the existence of prior knowledge, or knowledge that the organisation already has. An example of such knowledge is knowledge of the 'front line' of scientific or technological developments in a field.

What insights can absorptive capacity theory offer a strategic manager? For Cohen and Levinthal, for an organisation to create new knowledge, prior knowledge is needed.⁵² This has two components: knowledge that is similar to the knowledge being developed, and knowledge that is relatively more diverse, or different, from the knowledge that is being produced. According to Cohen and Levinthal,⁵³ there are two ways in which absorptive capacity can act to increase the innovative learning of an organisation: through 'cumulativeness' and through its influence on expectation formation.

The accumulation of absorptive capacity allows an organisation to more easily accumulate additional knowledge (cumulativeness).⁵⁴ The more knowledge an organisation has of a field, the easier it will be to pick up and evaluate signals that relate to technological changes, which can contribute to the organisations' expectations about change in a climate of uncertainty (expectation formation).

Because of the cumulativeness and expectation-related effects of the accumulation of absorptive capacity, path dependency can be created.⁵⁵ In other words, for another organisation to know the same they would have to follow the same 'path' of learning.

An important implication of path dependency is that if an organisation stops learning, or investing in its absorptive capacity in a field that is developing quickly, then it might lose out to other organisations.⁵⁶ It might not

be able to recover from these losses in knowledge accumulation; a case of 'lock-out' might occur. For Cohen and Levinthal, because lock-out can happen it is more costly to invest in absorptive capacity later. Opportunities might be lost because the organisation is less able to take advantage of them if they have lost ground in this way. Organisations might not develop their absorptive capacity because they may not have enough of it to know that such development is necessary.

A competency trap can also develop; where an organisation achieves performance with an inferior process and then stops learning about what might be better processes.⁵⁷ The 'not-invented-here' syndrome, where external knowledge is rejected because it is from an external source, can also be an indicator of lock-out. Organisations with higher levels of absorptive capacity, according to Cohen and Levinthal, are more likely to be proactive and able to exploit opportunities that they find in the environment. In contrast, other organisations with lower levels of absorptive capacity may be forced to be reactive, and be limited to their response to challenges, in that they might not have technical options.

Cohen and Levinthal offer an example of Schumpeter's process of creative destruction in the case of the change from electromechanical to electronic devices.⁵⁸ Many organisations that were established in the industry faced radical changes in the market structure, and experienced competence-destroying technical change. It is a core argument of Cohen and Levinthal that organisations that do not have sufficient knowledge in an industry might not ever be able to develop sufficient absorptive capacity because of its cumulative nature. An organisation's R&D activity can not only generate new knowledge, but can also generate absorptive capacity. Absorptive capacity theory predicts that if learning stops, an organisation can immediately start to fall behind competitors that continue to learn. An important aspect of this theory is that it places knowledge above other resources in the management of strategic innovation. This knowledge can be put to use to seize innovation opportunities by applying principles of value innovation to achieve competitive advantage.

9.2.2 Innovation opportunities: Value innovation and competitive advantage

Kim and Mauborgne studied different organisations in different industries, and found certain differences between these organisations that accounted for differences in both their profits and revenue.⁵⁹ Overall, the differences between these organisations related to one underlying factor: their strategy. Applying a value innovation strategy overlaps with some aspects of blue ocean strategy.

Less successful organisations were found to follow 'conventional strategies'; they focused on 'beating' their competition on different measures.⁶⁰ In contrast, the more successful organisations were found to follow a strategy of 'value innovation', which sought to do something 'new and different'; a process which was less focused on their competitors. The core principle of this 'value innovation' was that uncontested market space, or blue ocean, could be found in existing industries.⁶¹ Organisations applying this principle effectively made competition irrelevant by providing a 'quantum leap' in value, or vastly improved levels of new and better value, to customers.

This principle therefore goes far beyond the continuous improvements in products and services that organisations typically make. On the basis of their research, Kim and Mauborgne identified five fundamental differences between more and less successful organisations, based on dimensions of strategy. These are discussed as follows:⁶²

- *Industry assumptions:* The conventional strategic view tends to regard the conditions of an industry to be given. In other words, the conventional strategic view does not take into account how differences in industry assumptions can themselves be used to develop strategy, even in mature industry stages. In contrast, the value innovation logic stresses that 'blockbuster ideas' and 'quantum leaps' in value can provide an organisation with opportunities; even in industries that are mature. In the Opening case study, it is shown how Formule 1 redefined

their value curve, or the value contributed by different products and services in their portfolio of offerings, by breaking away from the existing conditions and assumptions of the hotel industry.

- *Strategic focus:* By comparing their strengths and weaknesses with competitors, organisations tend to let comparisons with competitors dictate their strategy choices. Kim and Mauborgne give the example of CNN, which did not follow the industry's format of new programming, but provided a 'quantum leap' in value; 24 hours of news at a fraction of the cost of news per hour. Competitors were monitored but were not used as benchmarks. Such organisations need to know which factors deliver superior value; they do not simply offer products and services simply because their competitors do. They will rather use these resources to look for, and offer customers entirely new sources of value, and in so doing will be more likely to achieve competitive advantage. This was the strategy chosen by Formule 1, as discussed in the Opening case study.
- *Customers:* Whereas organisations that usually look to keep and grow their customer bases tend to end up segmenting offerings to meet more and more specialised requirements of customers, those that apply value innovation look for shared features that customers value. The logic behind this approach is that more customers will appreciate considerable improvements in the value they are offered more than they will appreciate a focus on their specific needs. Some customers will be lost, however, but the majority of the market may be captured. Formule 1 designed their value curve, or the value dimensions that they offered, based on customer needs that they had in common.
- *Assets and capabilities:* Organisations typically firstly look at their assets and capabilities, and then from there look at what they can do based on these. In contrast, value innovator organisations do not limit themselves to their assets and capabilities; they consider starting again from scratch if they can find a way to offer a quantum leap in value to customers. Kim and Mauborgne give the example of the Virgin Group, who sold off their entire chain of small music stores and started music and entertainment megastores. Existing assets and capabilities can, and should, still be leveraged, but they must not limit the organisation's choices in finding and providing value to customers.
- *Product and service offerings:* In most industries, the products and services that are offered tend to structure how competition occurs. Value innovators, however, do not necessarily compete with competitors based on existing products or services, but look at the 'total solution' that customers want; how value can be added along the 'total chain' of what adds value to customers. For value innovators, the industry's definition of what products or services should be offered is yet another constraint to the provision of value to customers.

Despite the spectacular successes of organisations that have applied value innovation, such success does not last forever.⁶³ Competitors will inexorably begin to imitate the new value curves of value innovators. Kim and Mauborgne stress that organisations should not become caught up in the trap of 'conventional strategic logic'; they should not begin to defend their markets along the same value curve. Kim and Mauborgne give the example of the way Compaq entered the personal computer market in 1983 after IBM had established the industry's value curve. Compaq introduced a new value curve and achieved spectacular success. However, drawn into competing with Compaq, IBM defended itself by focusing on beating Compaq at what it did. Over-engineered products that cost more to manufacture were produced by both organisations. According to Kim and Mauborgne, what both organisations failed to realise was that a convergence of value curves was occurring; other organisations were starting to produce along the same value curve. Both IBM and Compaq faced difficulties. What was needed was another 'quantum leap'. Value curves are based on offering value, not on technology or competencies. There are implications for an organisation's management of innovation that derive from the organisation's value curve. If the value curve differs from that of the industry, then the organisation should 'harvest' its advantage in the industry, and should avoid innovation. By using geographic expansion and improvements in operations, imitation by competitors can then be controlled.

Value innovation, however, places equal emphasis on value and innovation.⁶⁴ Value without innovation tends to result in incremental improvements for the buyer. Innovation without value tends to result in improvements that are too futuristic and beyond the consumer's comprehension or foresight. For example, initially, the microwave oven was ahead of its time. When first developed, consumers were unconvinced that it had any value or relevance for them. Now, of course, most households see microwave ovens as indispensable.

Another way of looking at the link between value and innovation is that an emphasis on value places the consumer at the centre of strategic thinking, while the emphasis on innovation pushes the organisation towards totally new ways of doing things, rather than simply incremental improvements.

In line with the widely recognised constituent elements of value, according to Kim and Mauborgne, value innovation can take place on one or more of three platforms:⁶⁵

- *The product platform*: The physical product
- *The services platform*: Support services such as maintenance, customer service, warranties, and training for distributors and retailers
- *The delivery platform*: Logistics and the channel used to deliver the product to customers.

When attempting value innovation, organisations tend to focus on the product platform, and neglect the services and delivery ones. Kim and Mauborgne stress that value platforms should be rotated in the same way that farmers rotate their crops.⁶⁶ They provide the example of Compaq, who looked at customer needs across the industry and launched a simplified server, with good performance at a third of the price. When competitors began to copy their value curve, Compaq changed it again. Customer value was then added through innovative software that saved customers time in configuring server networks. This was very successful because the server hardware actually contributed only 10% to the customers' costs, unlike the costs of servicing networks, which were much higher. Continuing to focus on the value that could be added to customers rather than on beating competitors at what they did, Compaq worked on developing yet another value curve, this one based on meeting customer specifications while shipping within 48 hours of a customer placing an order. The lesson here is to use all three platforms to keep an organisation's value curve different from those of competitors.

Over and above keeping an organisation's value curve different from those of competitors, there are other opportunities offered by contexts like South Africa. An especially important way to take advantage of innovation opportunities is by using blue ocean strategies. These are now discussed.

9.2.3 Innovation opportunities offered by blue ocean strategies

What are the specific differences between red and blue ocean strategies? Kim and Mauborgne⁶⁷ found that organisations they studied differed in the strategies they used. Certain organisations used their competition as a benchmark. These organisations found themselves in existing market space, which tends to become overcrowded, which Kim and Mauborgne termed a red ocean strategy. In contrast, organisations that chose a blue ocean strategy sought to create a leap in value for both buyers and the organisation itself by rejecting the core idea of conventional strategy. This core idea is that there is a trade-off between cost and value, or between cost leadership and differentiation. Their research found that successful organisations were focusing on how to achieve low cost and differentiation strategies at the same time.

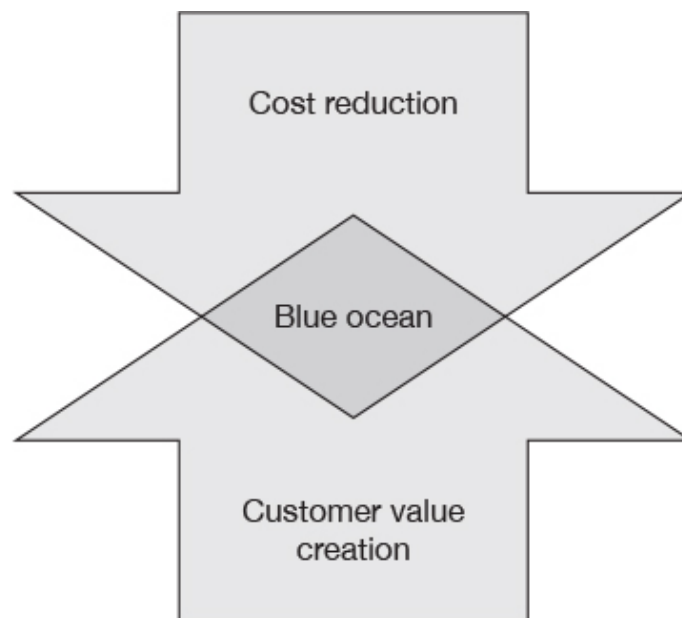
Table 9.1 Red versus blue ocean strategies⁶⁸

Red ocean strategy	Blue ocean strategy

Red ocean strategy	Blue ocean strategy
Having to compete in market space that exists already	Creating uncontested market space (creating new markets)
Having to beat the competition to succeed	Making the competition irrelevant
Having only existing demand to exploit	Creating and capturing new demand
Having to make value/cost trade-offs	Being able to break the value/cost trade-off
Having to align the entire system of an organisation's activities with its choice of either differentiation or low cost	Aligning the entire system of the organisation's activities to a focus on both differentiation and low cost

According to Kim and Mauborgne,⁶⁹ a blue ocean is created in the overlap between an organisation's cost structure and the value proposition it offers to buyers. As shown in the example of Formule 1, costs savings result from cutting away and reducing certain factors that the industry or industry segment competes on. But this is only one side of the approach. At the same time, buyer value is increased by raising and creating elements that have never been offered in the industry or industry segment before. Over time, scale economies will develop, which further drive down costs due to high sales volumes that come as a result of the superior value that is offered. Figure 9.3 shows this dual process of blue ocean creation.

Figure 9.3 The dual impact blue ocean process⁷⁰



Whereas red ocean strategies might be associated with military metaphors of strategy related to attacking the market share of a competitor, or focused on competitors, Kim and Mauborgne stress that blue ocean is about doing business where there are no competitors.⁷¹ Even the term 'competitive advantage' brings to mind images of outperforming rivals and competitively capturing greater shares of the market. Although competition still matters, the focus of blue ocean strategy is to identify and develop markets where little competition exists, and to exploit and protect these blue oceans.

Blue ocean strategies can be based on the use of technology. According to Markides, strategic innovation is not, however, the same as technological innovation, which is the use of new processes, machinery or applications that embody knowledge of how to do or make things.⁷² Notwithstanding this difference, knowledge of the influence of technology is very important because market creation and market destruction can both be strongly influenced by the use of technology, according to Markides. In developing a blue ocean strategy, you need to be able to view technology as a tool, or view changes in technology as an important source of new opportunity.

In creating a strategy, you need to be aware of the fact that technology acts through its influence on markets, as organisations can use this technology to develop new business models, or strategies that develop entirely new markets. This technology can also be used to replace existing markets. The importance of technology in market creation or disruptive innovation does not necessarily imply that you need to use the latest technology. Many market disruptions have been caused just by using new ways of combining relatively old technologies. In fact, certain technologies might not diffuse, or be adopted, until time has passed; or even not at all.⁷³ Notwithstanding this, new technologies can be very powerful 'game changers' in industries.

The gap between innovations and new technologies is reducing over time, as innovations lead to developments in technology and developments in technology lead to further innovations. Three important schools of academic thought are associated with strategic innovation: (i) value innovation; (ii) disruptive innovation; and (iii) bottom of the pyramid innovation.

It is important to understand that the different discussions in this chapter should not be considered, or applied in isolation. In the real-world context you will have to weigh up what strategies are best suited to different conditions. A 'silo' mentality, or having a perspective of one aspect of a business or a phenomenon, without taking into account its relationships with other aspects, is problematic. It is therefore important to be able to synthesise or bring together theoretical principles and to critically decide on appropriate strategies in the real-world context. Having discussed blue and red ocean strategies, the discussion now moves to business model innovation.

CASE EXAMPLE: Cirque du Soleil and the success of its blue ocean strategy

Kim and Mauborgne⁷⁴ offer the example of Cirque du Soleil to highlight the effectiveness of a blue ocean strategy. Cirque du Soleil is a 'circus' that invented a new industry segment by combining certain characteristics of a traditional circus with those of sophisticated theatre. It was able to catch up to the level of revenues of the best circus operators such as Ringling Bros and Barnum & Bailey in just 20 years. Importantly, this was done in an industry that was in decline, as sports, television and video games posed threats to the circus market.

According to Kim and Mauborgne, these challenges were aggravated by public sentiment that was hostile to the use (abuse) of animals,⁷⁵ thus demand was suffering. Supply, however, also posed problems, as star performers could charge what they wanted as they had market power. Cirque du Soleil sought to avoid the red ocean characteristics of the industry with its declining audiences and increasing costs, creating instead an uncontested market space and making the competition irrelevant. This attracted an entirely new category of customers, such as adults and corporate clients that were used to theatre, opera or ballet, and to paying more for their entertainment. This strategy has all the hallmarks of a blue ocean strategy. Red ocean strategies are associated with a known market space, where industry boundaries are defined and accepted, and the 'rules of the game' are typically well understood. The traditional circus industry was in such a state, and the only way to succeed in such an industry is to compete for a greater share of existing demand, but because this space will, over time, simply become more and more crowded, products tend to turn into commodities.

In overcrowded industries, it becomes increasingly difficult to differentiate brands, both in economic upturns as well as downturns. According to Kim and Mauborgne, this increasing intensity of competition 'turns the water bloody',⁷⁶ hence the red ocean analogy. It is innovation that offers the potential of a blue ocean strategy, and blue oceans have been the engine of growth over time. Industries such as mutual funds, cellular telephones, biotechnology, discount retailing, express package delivery and home videos are all examples of blue ocean

innovation. Blue oceans will also be the growth engines of the future. Thus, whereas the incremental extensions of existing lines associated with red ocean strategies contribute to revenues, it is investments in new markets and industries that contribute strongly to total profits.

According to Kim and Mauborgne, Cirque du Soleil found that they could strip away many of the traditional elements of the circus offering, doing away with animals and three-ring-circus acts, and keeping only three, namely clowns, the tent and acrobatic acts.⁷⁷ They focused on the elements that were kept, increasing the sophistication of the performances and trappings, and added theatrical content, with a coherent theme and story line for each performance. In so doing, Cirque du Soleil dramatically reduced its cost structure while at the same time achieving differentiation and adding value to customers (see [Figure 9.1](#)). The whole system of Cirque du Soleil's price, value and cost activities was successfully aligned, making this blue ocean strategy sustainable.

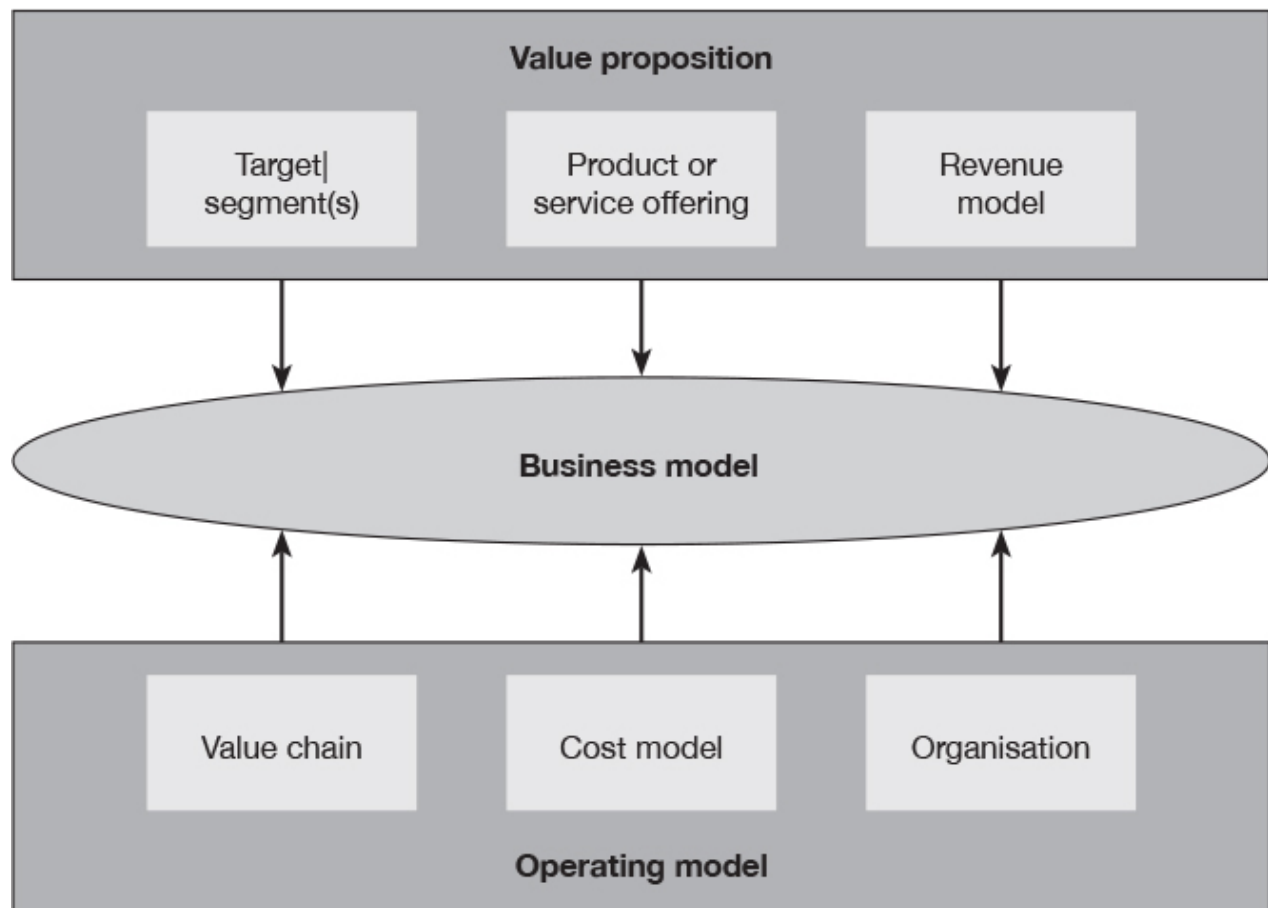
9.2.4 Innovation opportunities provided by business model innovation

What is business model innovation? A **business model** describes the reason, or rationale, for how a business creates, delivers and captures value.⁷⁸ A **business model** can answer the questions: (i) Who is the customer? (ii) What does the customer value? (iii) How do we make money in this business? (iv) What is the economic reason that explains how we deliver value to customers at an appropriate cost?⁷⁹ A business model can be taken to comprise of two elements, namely:⁸⁰

- the value proposition; and
- the operating model.

The business model and its components are shown in [Figure 9.4](#).⁸¹ These components are explained as follows.

Figure 9.4 The business model⁸²



The **value proposition** can be considered in terms of the question: what are we offering to whom? This question, in turn can be considered in terms of three elements, or choices:⁸³

- What target segment to target? Which customers and what needs do we focus on?
- What product or service offerings do we offer to customers?
- What revenue model to use? How are we paid for what we provide?

On the other hand, the **operating model** provides an answer to the question of how the offering is delivered in a profitable way, and relates to three elements or choices:⁸⁴

- *Value chain*: How is the business designed to deliver on demand to customers? How do we divide up what we do, to either do it in-house or to outsource?
- *Cost model*: How do we plan the structure of our assets and costs to deliver our value proposition profitably?
- *Organisation*: How do we allocate our people and develop them to maintain and improve competitive advantage?

Apple's approach in the late 1990s was based on the design of its own hardware and software, which was making it difficult to be price competitive.⁸⁵ What was a game changer for the organisation was its successful development of a business model for music downloads, notwithstanding the fact that previous attempts (e.g. by others in the music industry) had been unsuccessful. Because of their effective use of product innovation and business model innovation, from 2001 onwards products and services such as the iPod, the iTunes service and the iPhone allowed the organisation to capture a market about 30 times larger than their original market.

Why is Apple's example so important in today's business environment? Disruption now occurs more frequently in different industries, and business model lifecycles are becoming shorter.⁸⁶ There is increasingly more

competition, and businesses are off-shoring, or moving to where costs, particularly labour costs, are cheaper. Another problem businesses are facing is their exposure to systemic risk, or risk that is related to the fact that businesses are increasingly interconnected. If businesses are highly interconnected, then the impact of a shock to the market can spread to the system itself. An example of this is the financial crisis of 2009, where a crash in the housing market affected the entire financial industry. The pressure on businesses to be socially and environmentally responsible, together with all these challenges mentioned, also make it increasingly important for businesses to rely on innovation, and to use business model innovation as a way to renew competitive advantage and achieve growth in an increasingly challenging environment.

CASE EXAMPLE: How Discovery in the South African context shook up its industry through business model innovation

Drawing from an interview with Adrian Gore, McKinsey⁸⁷ explain how, through the use of business model innovation, the South African organisation Discovery overtook its competitors in the health insurance industry, and grew into a global player with a market cap of over \$8 billion. Central to this success is the alignment of rewards and risk, whereby an innovation score is part of every manager's performance evaluation. There is also an annual competition to come up with creative new ideas. It was the South African context in which its founder, Adrian Gore, developed his innovative strategy. South Africa was facing its transition to democracy and faced serious healthcare challenges. The new democratic government was focused on removing discrimination, and a healthcare insurer could not discriminate against customers on the basis of pre-existing conditions. There was also no public health-insurance system to cover any of the risk faced by a healthcare insurer. These conditions forced the starting organisation to undertake a strategy of innovation.

They focused on a core idea that the healthier people are, the more profitable health insurance could be.⁸⁸ Over 50% of mortality was associated with three core lifestyle choices, namely smoking, poor nutrition and lack of physical activity. They were approached by a gym chain who wanted to sell memberships and they came up with the idea of reversing this approach by offering points and rewards together with discounts on their premiums to those using gym memberships. Gore explains that this developed into their Vitality programme, a complete wellness system tracing physical activity and nutrition across time. Points can be earned by logging workouts with application devices, such as those offered by Nike+ and Fitbit, which synch across computers, mobile apps and smartphones. Healthy food purchased at partner grocery stores provide opportunities for discounts. The success of this model is the power of incentives. By incentivising customers to behave more healthily, they will make fewer claims – and Discovery makes greater profits. This is an excellent example of a powerful business model.

According to Gore, this model creates value for customers, the organisation and society.⁸⁹ Discovery Life is another successful product which after its launch in 2001 became the top provider of life insurance in the country. With the value creation that is generated by Vitality, Discovery benefits from a competitive advantage that its competitors lack. Vitality's business model structure allows Discovery to enter global markets – it is scalable, and can be used to partner with other insurers until strong enough to operate on its own.

The Vitality business model can be applied to other areas of human behaviour – it is an additive model.⁹⁰ For example, the organisation has extended it to motor insurance, given that people 'underconsume wellness', and neglect safe driving in much the same way as they can tend to neglect their health. The Vitalitydrive programme tracks driving behaviour via smartphones, rewarding good behaviour with lower premiums and discounts on fuel. Real-time emergency assistance is also provided.

According to Gore, the more one innovates, the more one can innovate.⁹¹ Whereas most organisations innovate as a response to competition, Discovery has launches every year where new product ideas are presented. Even though it is important to watch the costs, the key to success is to invest in innovation even when it is not clear what will come out of it. The internal competition held every year is termed 'Inspiring Excellence.' The top 1 000 leaders form small teams and work on innovative concepts. Then contests are held across the year until there are five teams left, which present at the annual conference. This process ensures a continuous

supply of innovative ideas, many of which when rolled out become big winners. The use of incentives extends to remuneration, as each business is given an innovation score, which determines take-home bonuses.

An important aspect of Discovery's business model is that it creates real value that can literally be lifesaving. It also contributes to South African society and the health of its people in addition now to those of others throughout the world!

Chesbrough explains certain opportunities and pitfalls of business model innovation.⁹² New ideas and technologies have to be commercialised by using a business model. Many organisations, however, do not have the capacity to innovate their business models. This can be costly, because the same ideas commercialised through different business models can have different economic outcomes. Indeed, a relatively poor technology commercialised through a good business model can be more profitable than a better technology commercialised through a poor business model. The printer and ink model is a good example of an effective business model. Chesbrough found that Xerox's copier/printer business made most of its profits on the paper and ink that it sold users of their copiers. He found that organisations often had at least as much to gain from developing a new business model as from a new technology.

Innovations within an organisation also need to fit with the organisation's business model to be successful,⁹³ otherwise they might only be able to flourish outside the organisation in another environment. In contexts of disruption, an organisation can use this as an opportunity to experiment with different business models. Chesbrough gives the example of the band Radiohead, which decided to experiment with a different model to release its album, 'In Rainbows' on the band's website instead of through the conventional process with its record organisation, EMI.⁹⁴ Visitors to the site could download their album, and could pay whatever they wanted to. According to Chesbrough, surprisingly, of three million visits to the site within 60 days of the release, two-thirds of visitors paid on average £4, with a net value of £2.67 on average, which was more than the band would have received if they had released it conventionally. Although the album was then licensed and sold through conventional distribution networks, the publicity received from this experiment led to greater exposure, and their album debuted at number one in the US and the UK, and performed better than their earlier ones. There are certain downsides to the use of innovative business models, however, of which a manager needs to be aware.

9.2.4.1 Business model innovation pitfalls⁹⁵

According to Chesbrough, there are certain pitfalls associated with business model innovation. New models can conflict with traditional structures of organisation assets. There can be resistance to experiments that are seen to threaten the ongoing value of traditional models. This can be especially problematic when the gross margins of the emerging business model are initially much lower than those of the traditional one. These models might have different customers or distribution channels. The new model might be starved of resources which are instead channeled to the still more profitable established technology. It is also necessary to know when to change your business model.

9.2.4.2 When to change a business model

Johnson, Christensen and Kagermann explain that business model innovations have changed or reshaped entire industries.⁹⁶ There are certain times when an organisation may need to change its business model. There are five strategic triggers for business model change, according to Johnson et al.:⁹⁷

1. If there are large numbers of potential customers who are locked out of a market because solutions are too costly or complicated, then there is an opportunity to apply disruptive innovation. This is also an example of where bottom of the pyramid (BOP) principles can be used. BOP strategies (to be discussed later in this chapter) are

strategies that target the poor as consumers 'at the bottom' of the demographic pyramid. Successful innovations that achieve a low-cost focus can tap into this market. An example of this is Tata's Nano, a very low-cost car.

2. An opportunity may arise to take advantage of a new technology by using a new business model. Examples of this are Apple's products and MP3 players, which took advantage of new technology to offer customers new ways of listening to music, and being able to carry large libraries of music with them as they moved around. Another way to do this is to leverage a technology that already exists by entering an entirely new market. An example of this is microwave technology, which was an offshoot of the space programme. In this case, the technology developed for the space programme was applied to an entirely different market.
3. An opportunity might exist for a 'job to be done' focus, or a focus on a need that can redefine an industry. An example of this is the way FedEx competed through meeting the customer need for quicker and more reliable deliveries of packages. In this case, this need forced a rethink of the way things were done in this industry, and a new way of doing things emerged as a new business model.
4. A change in business model may be necessary to protect against low-end disrupters. An example of such a threat is that faced by auto manufacturers needing to compete against the Tata Nano. Low-end disrupters are competitors that compete on the basis of low cost, typically by cutting out all unnecessary features. As a result of this disruption of markets, it may be necessary for an organisation to change its business model to fend them off.
5. A business model change may also be required if the basis of competition shifts. If leading core market segments commoditise, the entry of low-end entrants may require a response. For example, if the basis of competition is quality with high prices, but the segment shifts to compete on price, or low cost commodification has occurred (i.e. commodities are not differentiated – one unit is much like another), the organisation will need to change its business model to compete under these new conditions.

It is important to avoid business model reinvention unless the opportunity is big enough to make it worthwhile. It would also need to be not only new to the organisation but also to the industry. However, creating a new model should not mean threatening or changing the current one. The new model can also reinforce and complement the core business. The Case example of Dow Corning is now discussed to illustrate how principles of business model innovation can be applied to the real-life business context.

CASE EXAMPLE: How Dow Corning built a successful new business model from scratch⁹⁸

Johnson et al. give the example of Dow Corning who built a new business model from scratch. Dow Corning sold silicone-based products and technical services to different industries, but found product areas to be stagnating. They found that the low-end product segment was commoditising. Their problem was that their existing business model was based on highly priced innovative products and services. A new business model was developed that sought to drop the price point by 15%, and to formulate a new customer value proposition.

According to Johnson et al., this was found to need a fundamentally lower cost structure, which would only be possible with another IT system, and the use of the internet to automate processes and reduce overheads. This meant breaking the rules that had previously made it successful, and a change from a high-touch (much personal attention), high-quality service and differentiated experience to one that was low-touch, self-service and standardised.

But this meant an entire culture change would be necessary, and entrenched habits would be difficult to change. Because of this they decided to develop a new business unit with a new identity so that the old model could also be protected. After the new customer value proposition was articulated, and a new profit formula developed, sets of required new competencies, key resources and processes were identified.

Key to the success of this project, according to Johnson et al., was how existing expertise was leveraged, using key staff within the organisation that were less risk averse. Most successful new businesses typically revise their business models about four times or so in their pursuit of success. Trial and error is part of the process. Dow Corning launched the new business model, named Xiameter, and the investment in this new model was paid back in three months. Importantly, most of the new customers were new to the organisation, and the new model complemented the main business, and did not interfere with their ability to use premium pricing in the primary business. New technologies alone may not be enough. It is important to 'envelope' a new technology in an appropriate, powerful business model.

9.2.5 Innovation opportunities at the bottom of the pyramid

According to Prahalad, BOP markets can be a source of radical innovation.⁹⁹ The BOP market refers to the over four billion people in the world that live on less than \$2 (about R23.50) per day. This group of people is made up of different cultures, ethnicities, literacy levels, capabilities and needs, and as a market it is largely untapped and serviced by inefficient providers. It is possible to establish an organised private sector market in this 'space'. As countries develop, it is this market that will shift into the middle-class demographic.

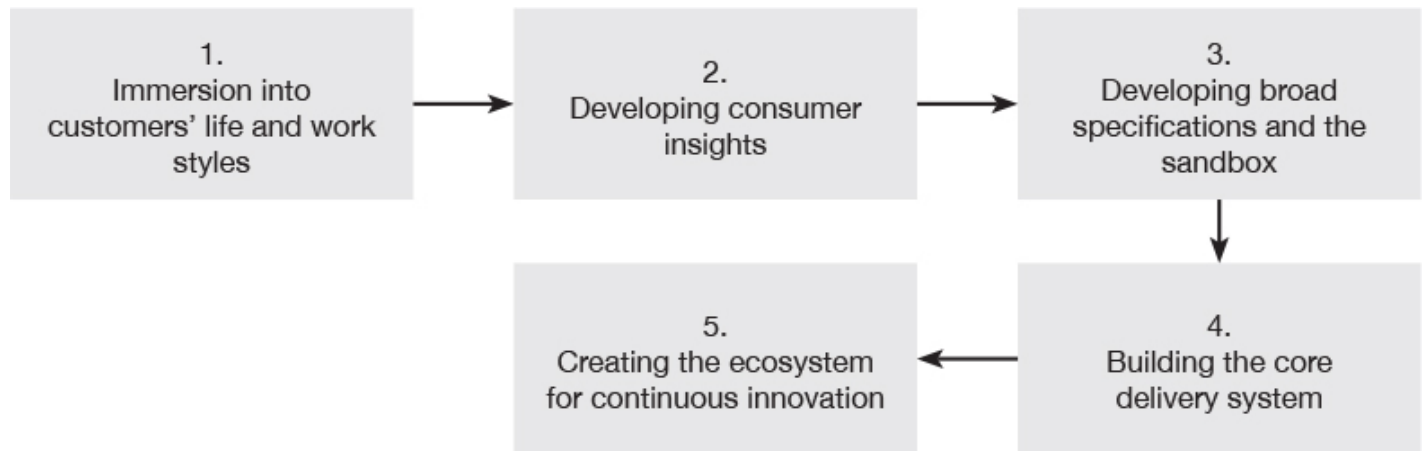
To apply BOP innovation, one has to think outside of technology and product perspectives of innovation and instead focus on total delivery of value.¹⁰⁰ Examples of products for this market include a \$2 000 (about R23 500) car, \$50 (about R587.50) cataract surgery, and airtime that costs \$0.01 (about R0.12) per minute. This is an important market in South Africa and sub-Saharan Africa. Prahalad uses the terms 'micro-consumers', 'micro-producers' and 'micro-investors' to suggest a more precise focus on smaller groups of consumers, producers and investors than are usually found in other markets. In this way, one can understand consumers with smaller budgets, producers that produce smaller quantities and investors that invest smaller capital shares. This is necessary to be able to tap the very large market that is made up of the poor. According to Prahalad, converting the BOP market into groups of micro-consumers, micro-producers, micro-investors and innovators requires a focus on the following four As (as opposed to the 4 Ps we know from marketing):¹⁰¹

- *Awareness* needs to be created, of the product and services.
- *Access* needs to be provided, so that even in distant areas consumers are able to get the products/services.
- *Affordability* is necessary, as world-class quality at very low prices is not negotiable. Quality is not the same thing as luxury.
- *Availability* is key, as a consistent supply cannot be disrupted. Building trust is important so as to be able to build a loyal base of customers.

Each of the four As has its own challenges, such as the need to create awareness without access to high-cost advertising, to access rural areas and deliver products and services in an economical way, to achieve the low costs necessary to achieve affordability, and to keep supply consistent without access to a high-cost delivery system.¹⁰² These challenges, however, are key to the development of breakthrough innovations, and must be accepted as constraints to work within, which Prahalad terms working 'within the innovation sandbox'.¹⁰³

Developing a detailed and in-depth understanding of consumers, and their needs, is key to this. Prahalad gives the example of developing a stove for the BOP market in India, using a video to document the cooking process visually from start to finish. This process was followed, again and again, to document the cooking process repeatedly, using different families from different areas of the country. This allowed for immersion into customers' life and work styles (the first stage shown in [Figure 9.5](#)). Content analysis and a clustering of the results allowed a 'deep dive' into the decision processes of the consumer (the second stage shown in [Figure 9.5](#)). This allowed the development team to start creating broad specifications for design and development (the third stage shown in [Figure 9.5](#)).

Figure 9.5 The BOP process for developing business specifications¹⁰⁴



The constraints the research team identified formed the ‘boundaries’ of the innovation sandbox in which they had to work, and the requirements to develop the business model became clear.¹⁰⁵ These included the need for a modern stove that was smokeless and easy to use, but it also needed to be aspirational (people would need to want it) and to meet global safety standards by design. Developing these aspects together with the necessary logistics provided the core delivery system (the fourth stage shown in Figure 9.5).

Prahalad stresses that it is important to understand that innovation in BOP markets is a continual process of learning and experimentation.¹⁰⁶ In the development of the stove for the Indian market, certain changes needed to be made along the way, but in the end it all came together. Innovation is therefore a learning process, and this process is key to the evolution of a business system – the system will evolve through different milestone points where changes will be made.

To meet the necessary awareness, access, affordability and availability requirements, it was important to build an ecosystem or network that was cost effective and scalable, and included the skills and knowledge to make a success of the business.¹⁰⁷ This is shown as the fifth stage in Figure 9.5. To do this, Prahalad explains that collaborations were formed with the Indian Institute of Science, who helped to develop the product, and non-governmental organisations to develop village-level entrepreneurs to stock the stoves and form the basis of the logistics system. A manufacturer was also identified.

From the discussions above, it can be seen that BOP implementation is also about reconceptualising how we think about business. To reconceptualise businesses and potential business models, Prahalad suggests the following guidelines:¹⁰⁸

- BOP can be seen as reducing the capital intensity of the business, so as to be able to spread capital needs (such as fixed assets and working capital) over the ecosystem so that one business does not carry all the load.
- BOP requires specialism within an ecosystem, as a business system needs to be created.
- Volume and scale need to be the basis of affordable pricing. According to Prahalad, to achieve profitability, large volume, low capital intensity, low margin per unit and high returns on capital are necessary. This is very different from the way most business work, or ‘gross margin’ thinking.
- Understanding the workflow is very important in building an innovative business system. Workflow and business processes are important, as workflow provides the guidelines you need to choose which partners to use for collaboration and to build the ecosystem.
- Unlike thinking related to better serving existing markets, to create a new market it is necessary to develop ecosystems for acquiring new customers.

According to Prahalad, with upwards of four billion new micro-consumers and micro-producers, BOP innovation allows us to access a largely untapped market.¹⁰⁹ However, Prahalad stresses that this requires a shift from product-centric focus to one on business model innovation, of which a product is just one aspect.¹¹⁰ Systems thinking is important to be able to do this. Innovation takes the form of developing an ecosystem. Many international organisations use BOP markets as a laboratory for innovation to help them to develop products for different markets, including wealthier ones. BOP innovation can be an important source of learning about how to improve price performance, how to use different technologies, and how to tap markets that, due to systematic structural change, are due to become middle class. Key to harnessing these abilities, however, is knowledge of how to develop an organisation so that it is supportive of innovation. The role of leadership in developing an innovation-supportive organisation will now be discussed.

9.3 Supportive organisations

9.3.1 The role of leadership in creating an organisation supportive of innovation

According to Rosing, Frese and Bausch,¹¹¹ the key challenge with leadership theory is that it often fails to take into account how complex the innovation process is, and that along the research process there are changing requirements. These changes primarily relate to the need for leadership to be able to switch between the exploration and exploitation modes of the innovation process. The ambidexterity theory of leadership for innovation therefore offers useful insights for leadership that is explicitly suited to the context of innovation. Whereas the ambidexterity theory of leadership provides useful insights through differentiating between two complementary forms of innovative leadership behaviour, transformational leadership theory holds the key to creating an organisational climate that supports innovativeness.

9.3.1.1 The ambidexterity theory of leadership for innovation

There are two different and complementary sets of leadership behaviour that enable exploration and exploitation, both in individuals and teams.¹¹² Exploration is related to increasing the variance of behaviours (different types of behaviours), experimentation, the search for different alternatives or solutions, and risk taking. These characteristics are very different from those associated with exploitation, which is typically characterised by reduced variance (fewer types of behaviours), following rules, alignment of processes and avoiding risk. Rosing et al. define ambidexterity theory of leadership as a form of leadership that can switch between these two complementary leadership behaviours. It is not enough to simply demonstrate a leadership style, but one has to flexibly adjust leadership behaviours to the nature of innovation tasks. Both of these processes, however, are forms of organisational learning. This theory has important implications for maintaining innovativeness in an organisation, as it suggests that not all behaviours are the same.

Ambidextrous leadership comprises three elements.¹¹³ Leaders can apply (i) opening behaviours to support exploration; (ii) closing leader behaviours to enable exploitation; and (iii) temporal flexibility so as to switch between (i) or (ii) as needed. Exploration relates to increasing variance in employee behaviour. Opening relates to breaking up routines and thinking in new directions, and is defined as 'a set of leader behaviours that includes encouraging doing things differently and experimenting, giving room for opening leader behaviours'.¹¹⁴ This means that when employees need to show creativity and high levels of innovativeness, opening leader behaviours are appropriate. Examples of opening leader behaviours include allowing different ways of completing tasks, and encouraging experimentation, independent thinking and decision-making.

Exploitation relates to reducing variance in employee behaviour.¹¹⁵ Closing leader behaviour is defined as 'a set of leader behaviours that includes taking corrective action, setting specific guidelines, and monitoring goal achievement'.¹¹⁶ Examples of closing leader behaviour include monitoring and controlling the attainment of goals, encouraging standardisation in task behaviours, and sticking to predetermined plans.

Evidence has been found to support the predictions of ambidexterity theory in working contexts.¹¹⁷ Another important theory that offers useful principles for how innovativeness can be maintained in an organisation is transformational leadership theory.

9.3.1.2 Transformational leadership

Transformational leadership is needed to proactively create an organisational climate that supports innovativeness.¹¹⁸ Bass defines the transactional–transformational leadership paradigm as either leading on the basis of contextual requirements (transactional leadership) or leading people 'beyond their self-interests for the good of the group, organisation, or society' (transformational leadership).¹¹⁹ On the one extreme of the spectrum is transactional leadership, and on the other is transformational leadership. The definition of transformational leadership in an organisational context is therefore a leadership style that leads people to go beyond their self-interests, prioritising the good of the organisation. Transactional leadership is defined as a leadership style that uses rewards and punishments to ensure compliance of employees. This style typically achieves compliance in the short term, as it might not motivate employees to commit themselves to the organisation in the same way that transformational leadership attempts to do.

Transformational leadership can contribute to innovation in ways other leadership styles cannot, as it is specifically concerned with change and innovation.¹²⁰ Transformational leadership seeks to increase the motivation, understanding, maturity and self-worth of staff.¹²¹ Whereas individuals might compete with each other in transactional groups, transformational groups are about shared goals. Similarly, whereas transactional organisations are characterised by rules and regulations, transformational organisations are well suited to innovativeness because they are more adaptable.

How does leadership work to encourage innovation? Leaders and followers typically enter into an exchange, which starts with a process of negotiation.¹²² Leaders can reinforce these transactional exchange commitments through their power, but there is a better way. A transformational leader motivates followers to work for transcendental goals that go 'beyond immediate self-interest'.¹²³ There are four interrelated components of **transformational leadership**.¹²⁴

- *Idealised influence* (charisma), according to Bass, relates to how a transformational leader shows charisma – a type of force of personality that inspires others – and also displays conviction, stresses the importance of trust, and is not afraid to take a stand on issues, even when this is uncomfortable. This component also relates to how a transformational leader can motivate others around a shared purpose.
- *Inspirational motivation* is a characteristic that describes how a transformational leader articulates a compelling vision for the future while expecting high standards. This calls for enthusiasm, optimism and encouragement while making the achievements of goals meaningful.
- *Intellectual stimulation*, according to Bass, relates to how a transformational leader challenges assumptions, traditions and beliefs, and gets others to appreciate new perspectives and new ways of doing things. Key to this is the way such a leader encourages the expression of ideas and reasons. This component is especially important for the creation of a climate of innovativeness in an organisation.
- *Individualised consideration* takes the form of treating others as individuals, considering their individual needs, abilities and aspirations, as well as being a coach and a mentor to contribute to their development.

On the other hand, according to Bass, the following are four behaviours that characterise **transactional leaders** in the way they achieve their goals.¹²⁵

- *Contingent reward* behaviours follow the principle of constructive path-goal transaction rewards, whereby expectations are made clear, and promises and resources are exchanged for leader support.
- *Active management by exception*. Leaders will monitor performance, but intervene only when deviations from standards occur, enforcing rules to ensure standards are met.
- *Passive management by exception*. This relates to the failure of a leader to intervene until problems grow and become serious, or only taking action when issues are brought to their attention.
- *Laissez-faire leadership* relates to a non-leadership component of transactional leadership behaviour, where leaders are unengaged, and do not intervene when necessary, allowing issues to occur 'on their own'. This 'hands-off' approach reflects disengagement from the leadership process.

Strategic innovation needs to occur in an organisational climate of innovativeness. You will need these leadership theories to provide principles for how you can ensure that an organisational climate becomes, and stays, innovative. There are certain important concepts that can help you to set up and maintain processes of innovation. The fuzzy front end of innovation and design thinking are two of these important concepts. These are considered next.

9.3.2 Supportive organisations: Setting up and maintaining processes of innovation

A strategic innovation manager needs to set up and maintain processes of innovation. Two important topic areas that provide useful insights into how to do this are the 'fuzzy front end of innovation' and 'design thinking'. These concepts are considered as follows.

9.3.2.1 The fuzzy front end of innovation

Front end innovation is the beginning point in an innovation process where one needs to come up with opportunities and concepts before the formal development process is undertaken.¹²⁶ The fuzzy front end (FFE) phase of new product development (NPD) is usually unstructured, dynamic and uncertain, as it is at this stage that idea development happens, followed by a stage of idea selection. Fuzziness relates to uncertainty about the extent to which an idea holds promise for commercialisation. There are many different reasons for this uncertainty, such as required technology, markets, resources, organisation fit, organisational capabilities, or other constraints and limits. Given this fuzziness, what then is the best way to approach this state of the development process?

The key is to reduce the uncertainty of the planning process, particularly by reducing technological and marketing uncertainty.¹²⁷ As the NPD process progresses, the level of fuzziness reduces. When it reduces enough for a decision to be made about proceeding, then the approval level is reached. The decision to proceed will usually depend on certain factors, such as tolerance for risk taking, strategy, technological readiness, whether enough resources are available, and other internal and external criteria. Differences between the fuzzy front end phase and the development phase are highlighted in [Table 9.2](#).

As can be seen from [Table 9.2](#), the nature of the FFE phase is very different from that of the development phase. To achieve success in the product innovation process you will need to successfully meet the objectives of this phase, and ensure the challenges associated with it are met. The consequences of not resolving these challenges can be costly. Projects that proceed to the next phase that have not been properly managed in the FFE phase can experience project delays, budget escalations and performance problems

What are the outcomes to strive for in the FFE phase? Or, in other words, what are the outcomes that you need to achieve to be able to move the project on to the next phase? Kim and Wilemon's outcomes are considered as follows.¹²⁸

- *Project selection and definition:* The most important objective of the FFE is to gain an understanding of project requirements and to create a clearly defined product. The development phase needs to proceed on the basis of a clear product definition. The main challenge, however, is that it is usually very difficult to clarify the product concept at the front end in a way that the product definition is clear and stable. Planning in the development stage requires this, and if this definition is not clear costs can escalate in the development phase, and once in the development phase projects can be 'costly to kill' or to stop.
- *Managing the time dimension:* Total FFE process cost is strongly influenced by the cost of delay. There are certain obstacles to achieving rapid and effective FFE performance. These include failure to plan properly, poor leadership, ineffective communication and poor allocation of staff. Sometimes, a delay at the FFE stage can lead to cost savings later if this results in a higher standard of work. This is not to say that losing time is good, and it is important to save time wherever it is possible. It is also important to match the speed requirements of fast-moving markets, where the costs of delays can be high.
- *Managing the people dimension:* Management behaviour and attitudes can influence the innovative performance of staff. This is particularly true of the FFE phase. Support and rewards can be effective in influencing the morale and behaviour of project members. This can be especially important in terms of transferring FFE learning to development teams, developing relationships that will be carried through to the development process, and also to solve problems in the FFE stage so that they do not cause further conflicts between functional departments in the development phase.

Table 9.2 Differences between the fuzzy front end phase and the development phase¹²⁹

Characteristic	Fuzzy front end phase	Development phase
An idea	Probable, fuzzy, changeable	Clear, specific, difficult to change
Information for decision-making	Qualitative, informal, not exact	Quantitative, formal, specific
Outcome or actions	A blueprint, reducing ambiguity to make yes or no decisions	A product, making it happen
Focus	Broad and shallow focus	Narrow and detailed
Idea rejection	Easy	More difficult
Degree of formalisation	Low	High
Involvement of personnel	Individual or small project teams	Full development team
Budget	Small or no budget	Large or designated budget
Management methods	Unstructured, experimental, a need for creativity	Structured and systematic approach
Costs of abandoning the project	Typically low cost	High cost
CEO commitment	Negligible	Generally high

When the development phase begins, those working in this phase will usually perform activities that are based on these three outcomes, or product definition, time and people dimensions, so it is particularly important to pay attention to them in the FFE phase. What also needs to be recognised, however, is that these outcomes are not achieved in isolation, but they can be interlinked. Lastly, it is also important to vary the stress on each outcome according to specific project and market requirements. Over time, learning that has occurred in the engineering and

design fields has been found to be very helpful in strategic innovation. This is termed 'design thinking' and is considered next.

9.3.2.2 Design thinking

Design thinking relates to the creative process used by designers during the designing process, which when applied to innovation plays an important role in strategic innovation. According to Beckman and Barry,¹³⁰ design theory has emerged from different disciplines that relate to the design process, as the complexities of new technologies that were changing human lives required a rigorous and explicit process for embedding these technologies in useful artefacts or products. 'First generation' design theories and methods used optimisation techniques from operations research as well as systems thinking approaches from the field of cybernetics, which apply principles of communication to control and feedback systems. However, 'second generation' design theories focused more on the social aspects of design, or on design as a social process that was less 'top down' and drew more people into problem-solving processes, including from different disciplines.

Over the past decades, however, the innovation process has become codified, and formalised, and in new product development typically follows a 'stage-gate' process, or a process which concentrates on whether an innovation can move from one stage to the next. The problem with this is that the innovation challenges faced by organisations today are increasingly broad and complex, and following formulaic strategies is simply not enough. What is needed is an understanding of 'the more fundamental principles underlying innovation'.¹³¹

What is different about design thinking? Design thinking is based on abductive reasoning, or reasoning that is empathic, personal, subjective and interpretive.¹³² It seeks to move from what is known to explore what could be.¹³³ Abductive thinking is used for problem solving in a way that balances needs for efficiency and predictability with those of experimentation. It is about thinking beyond what you see in front of you and imagining a radical solution to unmet customer needs.

How does one use design thinking to ensure successful innovation? To think like a designer, you would imagine solutions that meet customer needs, and then build entire systems to optimise customer satisfaction based on this.¹³⁴ Design thinking can be used as a way to see, shape and build. There are three phases to the design thinking process. These are the inspiration, ideation and implementation stages. These stages are not linear, and can be undertaken in different orders and repeated. The goal is to develop a deep understanding of what people want in their lives, and what they like about products, and how they are made, packaged, sold and supported. People develop ideas by failing, and failure is encouraged so that trial and error can be used to accelerate development. Certain principles behind the application of design thinking in the real-world context are now discussed.

9.3.2.3 Applied design thinking

According to Fraser,¹³⁵ the methods and mindsets behind excellent design in fields like engineering, industrial design and architecture can be just as effective in designing how a business can be modelled. Business design is therefore aimed at delivering market value and enterprise value. The key principles behind this approach are the following:

- A focus on enabling multidisciplinary collaboration
- Developing new ideas and possibilities rather than innovating incrementally, or slowly building on what had been done before.
- Sourcing creativity from constraints or challenges
- Early prototyping and quickly iterating, or making repeated changes to prototypes speedily, both in the lab and in the market
- Creating new and better models through systems thinking or paying attention to interrelationships.

Fraser suggests a methodology, or a method to use when applying design thinking, termed the Three Gears of Business Design.¹³⁶ The Three Gears of Business Design refer to how there are three processes that are interlinked in the way they drive successful business model design. This framework, brings together empathy and deep user understanding (Gear 1), which drives concept visualisation, ideation, prototyping and user evaluation (Gear 2). Concept visualisation in turn drives strategic business design, which comprises activity system design and evaluation (Gear 3). This is not a linear process or one that happens in a perfect sequence, but rather one that can be repeated by teams as they cycle through these three gears again and again to generate breakthroughs faster. It is important to note that this process starts with the first gear, in that without empathy and a deep user understanding of the customer there will be nothing to drive the other two gears. This requires knowledge of the context in which a customer uses a product or service.

Having discussed certain of the concepts that enable a manager to create an organisation that is supportive of innovation, our attention now turns to the management of the individuals that is necessary both to create supportive organisations as well as to take advantage of innovation opportunities. Indeed, it is the effort of the individuals you manage that will dictate the success or failure of your innovation efforts!

9.4 Innovative individuals

Innovation is highly dependent on individuals that feel confident in their ability and are organisationally enabled to be creative and innovative. As a starting point, one might ask, what makes an individual innovative in an organisational setting? Certain individuals are more inclined to be innovative than others. What then are the most important aspects of innovativeness at the individual level that a manager needs to know about? If we take individuals to be different and essentially unique, then we first have to ask how these differences relate to individual innovativeness. What theory can then be used to give us a recipe or a set of principles that we can use to understand this relationship? Firstly, personality theory suggests that individuals have different personalities, and that this has different implications for innovation in an organisation. Diversity is positively related to innovation, and it is important to empower individuals to be innovative. Personality theory is first introduced to develop an understanding of how individual differences relate to innovativeness. Next, building on the previous chapter and its explanation of how important values are for the management of organisational innovativeness, individual values will be discussed. Schwartz's values theory¹³⁷ predicts which individual values are most aligned with innovativeness, and which are not. Knowledge of individual values theory can help a manager to understand how individual behaviour can contribute to innovation in an organisation.

9.4.1 The unique individual

To understand innovative behaviour at the individual level it is important to understand that although they can share values, attitudes and beliefs, individuals are unique. A manager needs to respect all employees, and to also recognise that an acceptance of diversity and difference is key to developing an innovative organisational unit. There are also different personality theories. However, the one we will look at now is also a comprehensive theory, in that its dimensions arise from studies of people across different contexts. The personality theory discussed here is the Big Five theory.

Costa and McCrae¹³⁸ developed the Revised NEO Personality Inventory to measure personality according to the Big Five dimensions. Each of these dimensions is associated with different work behaviour. Costa and McCrae's dimensions are now each considered.¹³⁹

Neuroticism

Neuroticism (together with conscientiousness) has not been found to predict career choices as well as the other dimensions of extraversion, openness to experience and agreeableness. According to Costa and McCrae, individuals high in neuroticism have been found to experience higher levels of distress and dissatisfaction irrespective of their actual life situation. Individuals high in neuroticism are usually better suited to work that has low levels of stress and that require less emotional control, particularly in interactions with others. Knowledge of personality theory is particularly important for a manager who needs to improve organisational innovativeness because it allows him or her to better identify an individual's specific strengths and to build on them.

Extraversion

According to Costa and McCrae, extraversion is associated with gregariousness, a preference for engagement with others and social stimulation. Individuals high in extraversion typically display social skills, have numerous friendships, and tend to participate in team sports and social activities. Managers and sales roles have been found to be well suited to extraversion. Given that more innovative work is team oriented, it is important for a manager to support individual engagement in group work contexts, and knowledge of an individual's personality can be useful in matching task roles to individual strengths. Different personality types are suited to different roles and tasks.

Openness to experience

Openness to experience is related to a wide set of interests and to innovativeness. When building on the strengths of staff, a manager can build on the innovative strengths of individuals with high levels of openness. Such individuals usually have a need for variety, novelty and change. An individual low on openness may tend to be resistant to change and innovative ideas. These individuals might need more support to contribute to innovation in an organisation.

Agreeableness

According to Costa and McCrae, individuals high in agreeableness are expected to demonstrate compliance, or to defer to others during interpersonal conflict, and to display higher levels of cooperation. Someone low in agreeableness might tend to seek to dominate in group contexts, and be prone to conflict. Thus, managers need to be aware that group tasks differ from individual tasks, and that an increasing proportion of today's work is performed by teams. They need to understand the traits of individuals so as to support them and build on their strengths.

Conscientiousness

Individuals high in conscientiousness are typically hard working, dedicated and committed. This is the personality characteristic that has been found to be associated with success in work tasks and work performance across contexts. These employees usually receive higher performance reviews, and will contribute to the success of the organisation. They are particularly well suited to demanding jobs that require initiative, drive, persistence and organisational skills. A manager also needs to be aware that these employees achieve career success, but this can be at a cost to personal growth in other areas of their lives. Individuals that are low in conscientiousness may have lower levels of ambition, and they need to choose an appropriate type of job and work that is better suited to their motivation levels.

Individual behaviour is to some extent a function of personality, but this is only one aspect of what drives an individual's behaviour.

9.4.2 Innovativeness and individual values

Schwartz¹⁴⁰ developed a comprehensive values theory that offers us another individual-level theory that can explain certain aspects of individual behaviour in an organisation, particularly in terms of innovativeness. As an individual-level theory, it relates primarily to the individual as the unit of analysis. As with the Big Five theory, Schwartz's

values theory is also a comprehensive theory. Whereas the Big Five theory is a comprehensive theory because it categorises all personality types (predicting that they all fall into five primary categories), Schwartz's theory categorises almost all the values found in different cultures into one of 10 motivational types of goals, which in turn fall within four overarching domains. These domains are in opposition to each other, and derive from different aspects of human motivations.

Schwartz's values theory is important because it integrates three aspects of human motivations, namely:¹⁴¹

- biological needs
- needs related to coordinated social interaction; and
- needs associated with group survival and functioning.

Thus, there are biological, psychological and social components to individual motivational values. As a manager, knowledge of how individuals differ in their individual values can provide useful information as to which individuals may need more support to be able to be innovative and productive in different contexts.

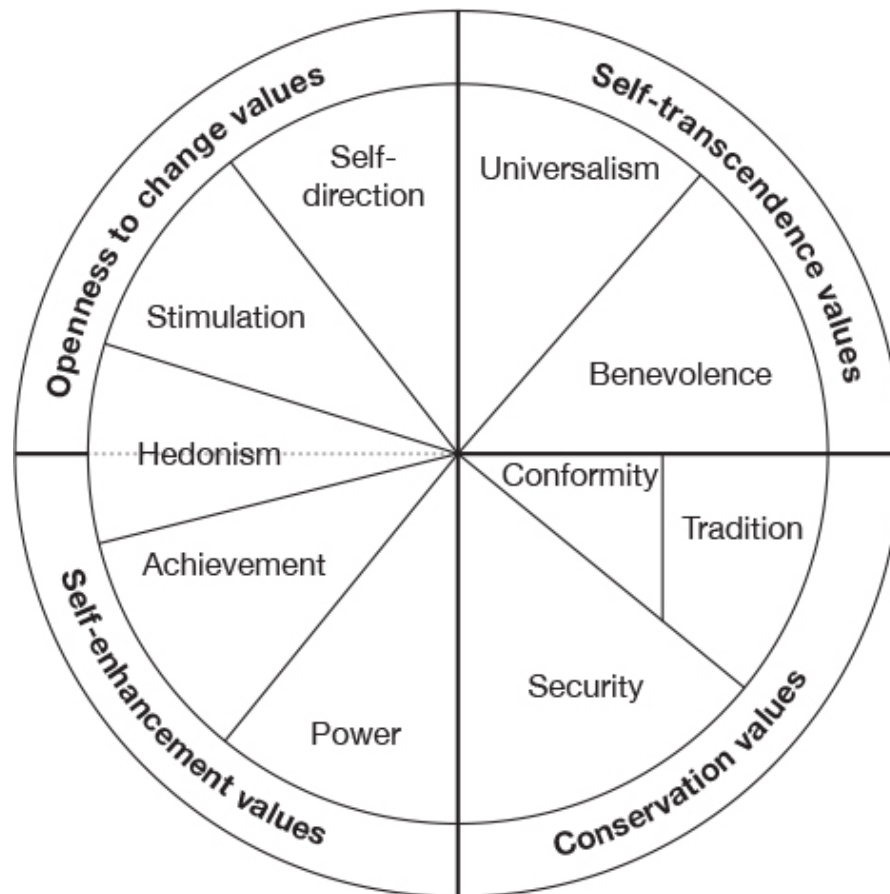
Schwartz's values are defined as motivational goals that serve as guiding principles in a person's life.¹⁴² These typically transcend context, or are not shaped by it, and are differentiated by the motivational goals they express. These 10 motivational goals, or values, form a structure with four oppositional domains. The structure of these 10 motivational values is illustrated in [Figure 9.6](#). Each value is located along a circular shape, which is called a circumplex.

Each value has a relative position in relation to the other values.¹⁴³ As such, a value is oppositional to another to the extent that the other value is facing it on the other side of the circumplex. Thus, for example, the conservation domain values relate to motivations of security, conformity and tradition, and are associated with low levels of innovativeness, but openness to change domain values (which oppose conservation domain values) are associated with high levels of innovativeness

The four overarching domains are comprised of openness to change values, which relate to innovativeness; conservation values, which are low in innovativeness; self-transcendence values, which relate to how an individual might prioritise the needs of others over his own; and, self-enhancement values, associated with achievement and power, or the prioritisation of the individual over the needs of others.¹⁴⁴

A manager can use this knowledge to understand the motivational values of others, as these are expected to reflect in individual behaviour. According to Schwartz, those who score highly on one dimension will score low on the opposite dimension, thus his values theory has a structure as well as content. Certain values are more strongly correlated with others, and these form a circle (as discussed, they have a circumplex structure) in the way they relate to each other. His individual values constructs are now discussed in more detail, beginning with the most important constructs in terms of innovativeness.¹⁴⁵

Figure 9.6 Schwartz's values structure¹⁴⁶



1. Openness to change values¹⁴⁷

Openness to change values comprise two values orientations that are related to innovativeness in different ways, namely self-direction and stimulation. Self-direction values are associated with independent thought and a drive toward action, decision-making and exploration. Individuals high in this motivational value orientation are typically independent, innovative and autonomous. According to Schwartz, these motivational goals derive from biological and social interaction needs.

Stimulation values are associated with excitement, novelty and challenge in life, and derive from a purely biological origin. Knowledge of whether individuals fall into this group is useful for a manager as it is they who will be more likely to support innovative change and to be more suited to driving innovative projects and tasks.

2. Conservation values¹⁴⁸

According to Schwartz, conservation values are oppositional to open to change values. Whereas openness to change values are associated with innovativeness, conservation values relate to the subordination of the self to socially oriented external expectations. The three motivational values falling into the conservation values domain are conformity, tradition and security values. Conformity values are related to subordination to those who are regularly encountered, or those with whom one is in regular contact. Tradition values relate to subordination to religious or cultural customs, or traditions in general. Security values prioritise safety, harmony and the stability of relationships. In work contexts, these values are expected to manifest in behaviour.

3. Self-transcendence values¹⁴⁹

Self-transcendence values, according to Schwartz, are oppositional to self-enhancement values in that they prioritise the welfare of others, as well as nature. There are two dimensions within this category, namely universalism and benevolence. Universalism is related to an appreciation for broadmindedness, social justice, equality and the protection of nature and the environment. Benevolence relates to the preservation and enhancement of the welfare of those with whom one is regularly in contact. Self-transcendence values are roughly equidistant from the high innovativeness pole of openness to change values and the non-innovativeness pole of conservation values. Where group goals contribute to innovative performance, individuals higher in self-transcendence values might be better matched to contextual requirements.

4. Self-enhancement values

Individuals with higher self-enhancement values are usually motivated to prioritise their own interests over those of others.¹⁵⁰ The category of self-enhancement values is made up of three motivational values, namely power, achievement and hedonism. It is important for a manager to be aware of the different motivational values of individuals, so as to be able to provide support and empowerment. Individuals with high self-enhancement values might prioritise their own interests above those of the group, and might need support to be able to contribute to group goals. Differences between people typically enhance the innovativeness of teams, however, and no trait should be considered negative, as every individual can make a contribution to the innovative performance of an organisation by building on their strengths and by improving any points of concern.

Power values are associated with prioritising social status, prestige, control or dominance over other people and resources. Schwartz's theory echoes the work of McClelland,¹⁵¹ who differentiates between a need for achievement values and a need for power, whereby managers have been found to have a higher need for power, whereas those that seek to achieve in an area have high achievement values. For Schwartz,¹⁵² achievement values are associated with motivational goals of success, competence and accomplishment, but differ from those of power in that the need to achieve does not necessarily extend to the need to have power or control over others or resources. The third self-enhancement motivational values orientation is hedonism, related to one's own pleasure, gratification and immediate gratification. Individuals with high hedonism values are expected to prioritise immediate and not delayed gratification. Delayed gratification has been found to be an important determinant of performance over time.¹⁵³ The value of hedonism shares certain characteristics with stimulation and achievement, which are on each side of it on the circumplex, Hedonism values are on the border of the self-enhancement and openness to change values.¹⁵⁴

Workplace implications

It is useful for a manager to be knowledgeable about an individual's strengths and weaknesses, and knowledge of Schwartz's theory can complement knowledge of personality theory in this regard. In some cases, individuals become less innovative as they progress in their careers and as they settle into roles shifting from openness to change values toward conservation values.¹⁵⁵ However, education can increase innovativeness through its positive association with openness values. Interestingly, students studying economics, accounting and business administrative subjects have also been found to have higher power and achievement values, whereas those studying language, literature, history, philosophy and religious studies were higher in tradition values.¹⁵⁶ Differences in values have also been found to relate to different political preferences.¹⁵⁷ To enable innovation in an organisation, it is necessary to understand what motivates groups and individuals, and to empower individuals to build on their strengths and to be aware of their weaknesses and address these too.

There are many facets of individual behaviour. These are reflected in the many psychological constructs that you have encountered over the course of your management studies. These are also reflected in the interactions of the individual with others and with the culture of the group, and of the organisation itself. This section has sought to

give you an overview of the individual, and to provide you with useful theory to be able to harness the different talents and motivations of those you work with.

Putting it all together

This chapter sought to provide a potential strategic manager with a toolbox of theories and guidelines to be able to develop and maintain an innovative organisation or organisational unit in the South African business context. This section built on the previous sections, as innovation opportunities were initially presented, with a special focus on opportunities associated with disruptive innovation. After this our attention turned to how to develop supportive organisations to support these opportunities. Finally, in this section we explored theory that identified innovative individuals, providing useful knowledge of how to build on the different dimensions of individual strengths and how to mitigate individual weaknesses. The final lesson of this chapter is that the knowledge presented here is not enough to prepare you to manage innovativeness in an organisation. You will have to be able to source knowledge as and when you need it in your role as a manager. In today's world, knowledge is just a click away, but to use it you will need to have a good grounding in the theory of innovation or its basic principles. Hopefully this chapter has provided you with such a grounding!

9.5 Summary

In this chapter, we have come to understand that there are different aspects of strategic innovation, which together provide us with the knowledge we need to make different types of strategic choices. We also came to understand that the application of strategic innovation principles can follow a systematic process. First, opportunities for innovation were the subject of the initial portion of the chapter. In order to survive and prosper in an increasingly competitive global context, a business manager needs to understand the patterns and regularities that underlie the forces of innovation, and those of disruptive innovation in particular. Certain seminal innovation theories were therefore introduced to provide certain of these insights. Kondratiev's long-wave theory was outlined as a theory which helps us to predict the long-term changes in technology and innovation faced by organisations. Schumpeter's theory of creative destruction was then explained, which allowed us to see that uncertainty and disruptive innovation is a natural characteristic of the market system. After this, Foster's S-curve theory was considered, which showed how to map an organisation onto its technological S-curve, and to understand when disruptive innovation might be more likely to occur in an industry. Dominant design theory was explained in terms of how it can be used to identify factors that can enable organisations to establish a dominant design in certain industries. Absorptive capacity theory was then discussed, which stresses the role and importance of knowledge in dealing with disruptive innovation. Value innovation was explored in terms of how it can help an organisation seize opportunities. The characteristics of blue versus red ocean strategies were then considered, and the advantages of blue ocean strategies were discussed in terms of their unique strategic benefits. Given South Africa's substantial potential for BOP innovation, examples of BOP innovation were used to highlight how one could apply these principles in a real-life business context. In order to be able to seize innovative opportunities, a supportive organisation needs to be able to provide the leadership, processes and systems to support innovation. As a manager, one needs to manage people, and leadership theory was therefore introduced, with specific reference to two leadership theories, namely the ambidexterity theory of leadership for innovation and transformational leadership theory. To successfully apply strategic innovation it is necessary to set innovation in motion and to maintain its momentum in an organisation. The fuzzy front end of innovation was therefore introduced in order to better understand how to set the product development phase in motion, and design thinking was explained as a method to show how the innovation process can benefit from informed design processes. The chapter closed with a discussion of personality theory and individual values theory as it relates to innovative individuals. The chapter sought to provide you with useful principles that you can use to

seize innovative opportunities, build supportive organisations, and manage the innovative individuals you will find in the real life South African business context. Now it is up to you to put all of this into practice!

REFLECTION BOX:

- Can you think of any products you consume that might have been developed using a blue ocean strategy?
- Can you think of others that are associated with a red ocean strategy?
- Think of a BOP innovation opportunity that exists close to where you are. What do you think prevents someone else from taking up this opportunity?
- Reflect on how your views have changed, considering that disruptive innovation and 'creative destruction' may be a natural part of life in business.
- How do you feel about being a strategic manager in a context where 3D manufacturing and other innovative changes not only change the rules of the game, but can also change the very nature of the game itself?
- How do you feel about the possibility, in the future, of creating your own value curves using value innovation in almost any context?
- Think of a business that no longer exists due to disruptive innovation. Now think of another that you think will be disrupted by technological innovation.
- Think of your own strengths and weaknesses, and make a list of them. Now relate them to personality theory and individual values theory. Do you agree that self-knowledge can give you a better idea of how to build on your strengths and work to improve on your weaknesses? Now think of how you can apply these insights in the workplace.

Opening case study questions

1. Relate the principles behind the changes in strategy made by Formule 1 to another organisation's launch of a new product.
2. Explain the value of this new product.
3. Explain the differences between the value innovation strategy applied by Formule 1 and conventional strategy. With reference to your explanation, discuss certain weaknesses associated with conventional strategy.

Discussion questions

1. Compare and contrast the theories of innovation with the help of practical examples.
2. Explain what is meant by value innovation and how it can be used to establish competitive advantage.
3. Explain why following a blue ocean strategy might be considered to be a rejection of a central tenet of historical strategic management practice.
4. With reference to a business example of your choice, critically evaluate their application of value innovation. Give specific real-life examples.
5. Explain exponential technologies and identify how organisations could use them to develop new value curves. What are the potential consequences of the development of these innovations on markets?
6. Give three examples of businesses that have successfully applied BOP innovation. Identify their products and discuss how they were developed.
7. Describe a time that you were under a leader who had characteristics associated with transformational leadership. How did this affect your innovative performance under this leader?

8. With regard to three products of your choice, try to describe the fuzzy front end process that was used to initiate the development phase for these products.
9. Explain how you would use design thinking in the innovation process.
10. Explain why it is so important to use an S-curve to know when a technology may be facing radical innovations.
11. Critically discuss how an organisation can apply the principles of dominant design theory to establish their standard in an industry.
12. Explain how absorptive capacity can be used to maintain competitive advantage in conditions of uncertainty.

Using knowledge and skills

1. Visit a business that makes a range of products. From your research at this business, identify which of the products are associated with blue or red ocean characteristics.
2. Also, from your research, identify which products have been developed using the principles of value innovation.
3. Visit another business that has successfully applied BOP innovation. From your research, plot the processes they used to develop the BOP product offering.
4. Visit a business that sells technological products. Identify which of their products might have disrupted the market.
5. For the same organisation, draw the S-curve related to the underlying technology of the industry it is in, and make recommendations for how the organisation can avoid being disrupted by new technology.
6. For the same organisation, for a product, identify the dominant design in the industry, and explain what factors typically associated with the achievement of a dominant design are present for this organisation.
7. For the same organisation, explain how they manage knowledge in order to maintain their competitive advantage.
8. Think of what your own leadership style is or would be in an organisation. How does your style compare to those discussed in this chapter? How would this knowledge help you to improve the innovativeness of an organisational unit you are managing?
9. Identify an existing organisation of your choice and compare its innovation-supporting processes to those described in this chapter. What recommendations would you make for the organisation?
10. What are your own most important individual values? In order of importance, list the most important six. Think of how these values relate to innovativeness. What insights from this exercise would you use to improve your innovativeness in the workplace?

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CHAPTER 10

Corporate level strategy

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LEARNING OUTCOMES

After reading this chapter, you should be able to:

- explain what corporate strategy entails
- comment on the strategic management process and when corporate strategies are crafted
- differentiate between the corporate strategic options
- explain the role of the corporate parent
- critically evaluate the corporate strategies in a multi-business organisation
- comment on the use of matrices in managing the corporate portfolio.

KEY TERMS

bankruptcy

consolidation strategy

cooperative strategies

corporate parent

cost cutting (or downsizing)

defensive strategies

diversification strategies

divestiture strategies

greenfield venture strategy

harvesting strategy

joint ventures

liquidation

market development strategies

market penetration strategy

organic growth strategies

parenting advantage

product development strategy

recovery strategies

related diversification strategies

retrenchment

strategic alliances

unrelated diversification strategies

unfriendly takeovers



Super Group – complementary acquisitions are key to its success

Super Group is an integrated mobility business and listed on the JSE. Founded in 1986, Super Group has an international footprint¹ and is known for its success in integrating supply and demand management within and across companies. It aims to be the leading transport logistics and mobility group, and offers end-to-end supply chain solutions, fleet management and dealership services to a diversified customer base in Africa, Australia, the UK, Europe and New Zealand. Its strategic focus is to expand internationally through market development into selected African countries, securing long-term business contracts and building on its world-class competencies. The Super Group stable is structured around supply chain, fleet solutions and dealerships.

Super Group Supply Chain Africa includes transportation, warehousing and distribution, and comprises SG Freight, SG Coal, Legend, Phola Coaches and African Logistics. On the warehousing and distribution side, Super Group has SG Consumer, Super Park Warehouse, SG Convenience, SG Mobility and Digistics.

Super Group Fleet Africa offers fleet solutions within southern Africa.

Super Group Dealerships SA consists of franchised dealerships based in the provinces of Gauteng, North West and Western Cape. The table on the next page offers a description of the Super Group business model.²

Super Group's business did not always run smoothly, however. In 2009 it hit an all-time low and its founder resigned. A year later, Super Group appointed a new CEO and CFO, and returned to profitability. From 2010 onwards, Super Group restructured its fleet and set off towards acquiring interests in Fleet Africa Eastern Cape and acquiring the Volkswagen and Audi Rustenburg dealership. In 2012, Super Group acquired Haulcon (SG Bulk), a specialised bulk dry powder and liquids distribution business. This was followed with acquisitions of the Chrysler, Jeep and Dodge East Rand dealership. In 2013, Super Group expanded even further with the acquisition of 75% interest in Safika Oosthuizen, a logistics services company that provides hauling of dry bulk goods such as coal, chrome and 'run of mine minerals' in tipper trucks. This acquisition was followed by another acquisition in 2014 when it ventured into vehicle distributorship with a 50.1% interest in GWM Southern Africa. By 2015, Super Group increased its footprint further by acquiring a 75% interest in the passenger transport solutions provider, Phola Coaches. This was followed with further acquisitions – Biggest SA Trading and Ice House Liquor Merchants with more dealerships in Mpumalanga, Roodepoort and the East Rand.³

During February 2018, Peter Mountford, CE of Super Group, confirmed that the group was open to acquisitions in South Africa and the right opportunities in Europe after a period of consolidation. The success of its acquisitions can be attributed to the detailed analysis of opportunities. He stated that the group looks at the right strategic opportunities, whether they were in southern Africa or elsewhere, and that it was looking at further acquisition opportunities in SG Fleet in Australia and also in South Africa.⁴ Super Group's future strategy is to continue to explore investment opportunities internationally and in South Africa to maintain its position as an innovative, integrated mobility solutions company.⁵

Supply chain		Fleet solutions	Dealerships
Transportation	Warehousing and distribution	Fleet Africa A market leader in fleet solutions within southern Africa	Dealerships SA The dealerships business consists of franchised dealerships, based in the provinces of Gauteng, North West and Western Cape
SG Freight (including SG Bulk) This is a freight, bulk dry powder and liquids distribution business. SG Freight provides a national primary haulage service across the country with deliveries also being made into Botswana, Namibia and Mozambique.	SG Consumer The distribution of fast-moving consumer goods (FMCG) and staple foods from the manufacturers to wholesalers and retailers in South Africa	SG Fleet SG Fleet is a leading fleet service provider in Australia with operations in New Zealand and the UK. SG Fleet owns NLC, a leading novated product development and consumer finance business in Australia. Fleet Hire and Motiva, the acquired fleet management services businesses in the UK, have increased SG Fleet's geographic presence	Dealerships UK Allen Ford (UK) Essex Auto Group Slough Motor Corporation
SG Coal Provides the hauling of dry bulk goods such as coal, chrome and 'run of mine minerals' in tipper trucks. It is a logistics services company that provides the hauling of coal for coal mines.	Super Park Warehouse Super Group's bespoke warehouse facility in Johannesburg with three distribution centres across South Africa		
Legend A logistics services company that provides the hauling of coal for coal mines	SG Convenience The largest national SA distributor in the convenience distribution market segment, distributing to over 23 000 outlets (forecourts, hospitals, hotels, etc.)		
Phola Coaches A business providing passenger transport solutions for the educational, mining, power generation and construction industries	SG Mobility The distribution of automotive spare parts for a number of OEMs in South Africa		
African Logistics Provides long-distance, cross-border transport, clearing and forwarding, third-party distribution and transport brokerage in sub-Saharan Africa	Digistics Procurement and food distribution business which currently distributes multi-temperature-controlled product portfolios for McDonalds, KFC, King Pie and others		

Overview

Strategy formulation is not an optional extra in the strategic management process – as stated earlier, it is a deliberate course of action chosen to create or sustain a competitive advantage. Strategies are the routes that will take the organisation to its destination – the strategic intent of the organisation. This chapter explores various corporate level strategies and offers insight into the strategic options available to an organisation to gain competitive advantage by operating several businesses simultaneously. Corporate level strategies are aimed at growing the business or defending it in a multi-business context. Corporate level strategies are also referred to as grand strategies or strategies for the multi-business organisation. Choosing the most appropriate corporate level strategies forms part of the strategic decision-making process. Business level strategies were discussed in [Chapter 8](#). In that chapter, they were described as strategies to decide how to compete and build strategic competitive advantage in organisations that mostly operate in single industries. Corporate level strategies, on the other hand, entail strategies that extend beyond single-industry businesses, and deal with the organisation's choices for products and markets. When developing corporate level strategies, strategic decision-makers, or **corporate parent**, answer questions such as whether or not the organisation should focus on just a few products and markets, or whether it should have a much broader focus in terms of its scope by offering diversified products or services and/or serving diversified markets. The corporate parent represents the organisational headquarters of a diversified group of companies. With growth strategies, the strategic decision-makers, or corporate parent, can opt to grow the business through internal expansion, such as reaching new markets with existing products. Another option is to grow the business or businesses through buying other organisations, such as an acquisition or forward integration.

10.1 Introduction

The Opening case study *Super Group – complementary acquisitions are key to its success* explained the growth in the Super Group business portfolio through acquiring related and unrelated businesses. As with multi-business organisations, the Super Group business portfolio comprises business units that devise their own strategies, function under their own profit centres and with their own management team – all under the oversight of the corporate parent. With the Super Group, the business portfolio is grounded in mobility within supply and demand management. However, **corporate strategies** aimed at growing the business are not always based on businesses and industries that are related. It is possible for a corporate parent to venture into unrelated industries. The Bothongo Group,⁶ for example, started off as a commercial property owner and then branched off into agriculture and hospitality divisions as well as environmental cleaning products, furniture, events and décor services, and aviation services. The Case example *PEPmoney* describes how PEP Stores entered a line of business not related to its existing offering of clothing and homeware.

CASE EXAMPLE: PEPmoney

PEP, the biggest single brand retailer in Africa, lauds its customers as remarkable people who, on a very small budget, make it possible for their families to live with dignity and pride. Over the years, PEP expanded its offering from clothing and footwear to homeware, fast-moving consumer goods (FMCG), and cellular and airtime products. One of the latest additions is PEPmoney. The newly launched PEPmoney debit card is the cheapest bank card in the country. It is a full transactional card that also gives customers interest on their balance. Through the app or USSD string, customers can check their balances, buy airtime and electricity, pay bills and transfer money. A PEPmoney to PEPmoney transfer is the cheapest money transfer in South Africa.⁷ Not only did PEP diversify its business, but it also offered a solution for those who had left their families and loved ones and trekked to cities to look for employment. In the past, the families left behind might go for months without receiving any form of financial assistance. PEP answered this need by offering a reliable money transfer service that allows working people in cities to send money back home to their families through a brand that has been a trusted household name since 1965.⁸

Strategic choice is an ongoing process rather than an event, and requires flexibility. As explained in [Chapter 1](#), strategies can be deliberate or emergent. Prudence requires the tweaking of plans ahead of predicted change. Thus, tough times ahead may trigger a change from a growth to a defensive posture. From time to time, multi-business corporations restructure themselves by creating new divisions or subsidiaries while scaling back in other areas. As discussed in the Case example *Business overview of Naspers*, the Naspers Group operates at several business levels of print media, pay television and internet trading. Each subsidiary, like Media24, MultiChoice, Showmax, [takealot.com](#) and Remitly, has its own competitors and makes strategic decisions at the business level, as described in [Chapter 8](#). The Naspers Group headquarters (or Naspers corporate parent) operates at the corporate level when it makes decisions across all the various subsidiaries. Such corporate decisions may be about **diversification strategies** into new markets.

In this chapter, most ideas and examples involve the private sector. However, the principles of corporate strategy also apply to the public sector. Government-owned Transnet, for example, continues to turn its business around, while Broadband Infraco, a licensed state-owned company in the telecommunications sector, is growing through market and product development.

CASE EXAMPLE: Business overview of Naspers

Founded in 1915, Naspers is a leading multinational media group and was listed on the JSE in September 1994. The company is also listed on the LSE (London Stock Exchange). Naspers operates in more than 120 countries

and markets with long-term growth potential.⁹

Over the past three decades the group has evolved from a traditional print media business in one country to a broad-based e-media company in multiple markets addressing societal needs in markets that offer the greatest growth potential.

The Naspers Group is organised into six business areas: Classifieds, Payments, B2C eCommerce, Ventures, Video Entertainment and Media.¹⁰ Most of Naspers's businesses hold leading market positions, which adds value to shareholders through a stronger share price. The Naspers Group typically focuses on large consumer trends where they try to identify changes early, adapt suitable business models for the high-growth markets on which they are focusing and leverage their position to build great businesses that have scale, are profitable and generate a healthy cash flow.¹¹

The Classifieds business provides mobile and digital marketplaces that connect more than 300 million buyers and sellers every month in 40 countries around the world. Their payment platform, PayU, focuses on markets with long-term growth, and has leading positions across Africa, the Middle East, Central and Eastern Europe, India and Latin America. PayU offers 250 payment options that enable safe transactions for more than 160 000 merchants. Their B2C eCommerce segment contains their consumer e-commerce companies and investments, and include eMag, Flipkart, Longa and Takealot. The Naspers Ventures team hunts for new opportunities to back high-potential internet businesses and help their founders to scale globally. Video Entertainment offers, through MultiChoice South Africa and MultiChoice Africa, quality entertainment anytime, anywhere and on any device to more than 10 million subscribing households in around 50 countries across sub-Saharan Africa. Their Media business offers more than 40 magazines and 80 newspapers, and reaches more than 13 million monthly unique browsers across its digital platforms.¹²

The Naspers operating model is unique, which, some argue, is what adds value to its owners. Naspers invests in and runs leading companies, and aims to add value at all life stages. They create their own businesses or invest in early-stage companies, grow them to scale and hold investments in listed companies with significant upside.

This chapter deals with corporate level strategies and includes a discussion on corporate parenting and matrices to use in managing the corporate portfolio.

10.2 What corporate strategy entails

Corporate strategies are also referred to as grand or master strategies. These provide direction, and represent roadmaps that the organisation can use to achieve its strategic goals. Porter¹³ argues that corporate strategies are those strategies that make the corporate whole add up to more than the sum of its parts. Porter also warned that organisations may opt for inappropriate corporate strategies that can dissipate rather than create shareholder value. The business environment offers many cases of failed corporate strategies, such as unsuccessful mergers and acquisitions. During 2017, South African mergers and acquisitions deals halved,¹⁴ which may be indicative of cautious strategic decision-making amidst uncertainties in the industry and recognised complexities related to mergers and acquisitions. Some organisations (such as Naspers or Super Group) operate two or more strategic business units and require an overarching strategy for building value for their owners. Value is added when synergy is created – in other words, when the organisation as a whole is valued in excess of the sum value of its component units. Value can also be added through unrelated diversification, as is seen in the Case example of PEPmoney. Other organisations, such as Apple Inc, elect to focus on a single business instead of diversifying. While seemingly risky, specialisation enables organisations to hone their skills, understand consumers better, and offer customised products and services, unlike those who spread themselves thin. Organisations who want to grow their market share may choose to do so through creating more value with their existing operations or by buying additional capacity to add more value, as was described in the previous Case example about Naspers. Again, the decision whether to make

use of existing resources and markets to grow the business, or to buy other businesses or form alliances with other organisations is influenced by a range of factors. The various corporate strategy options also need to be evaluated against the criteria described in [Chapter 8](#) to ensure that the most viable strategies are chosen.

- Corporate strategy addresses two basic questions:
1. What and how many businesses and industries should we operate in?
 2. How can we build synergy and competitive advantage among business units? In other words, how should the corporate headquarters (parent) manage the portfolio of businesses to create value?

To illustrate the corporate strategy questions, we refer again to the Naspers Group. Firstly, the strategic management team would ask what and how many businesses and industries they should operate in. Naspers started as a printer and publisher of newspapers and magazines in 1915.¹⁵ The strategic management team later opted to expand the business to book publishing, and later incorporated pay television, video entertainment, internet platforms and classifieds. The corporate level strategy was to grow the Naspers business through related diversification. In answering the second question about synergy and competitive advantage, the strategic management team opted to organise and rebrand its print media under the Media24 umbrella in 2000. Through this corporate strategy, synergy was created among the various subsidiaries, and the Media24 brand was developed into a strong brand that makes it difficult for smaller competitors to compete against. [Table 10.1](#) offers the considerations to making strategic decisions. The focus of this chapter is mostly on the content on the left side of [Table 10.1](#) and deals with corporate level strategy.

Table 10.1 Considerations when making strategic decisions

CORPORATE LEVEL STRATEGY CONSIDERATIONS		BUSINESS UNIT LEVEL STRATEGY CONSIDERATIONS
• What and how many businesses and industries should we operate in? • Do we want to specialise on related products or services? • Do we have the competencies and resources to expand our markets and the industry in which we operate in? • Where do we see ourselves in the future?	What is our purpose? What is our mission? Why do we exist? What are the best strategies to achieve this?	• What is our source of competitive advantage and how can we use it to compete successfully? • Who are our customers? • What are our competitors doing? • Is our target market broad or narrow?

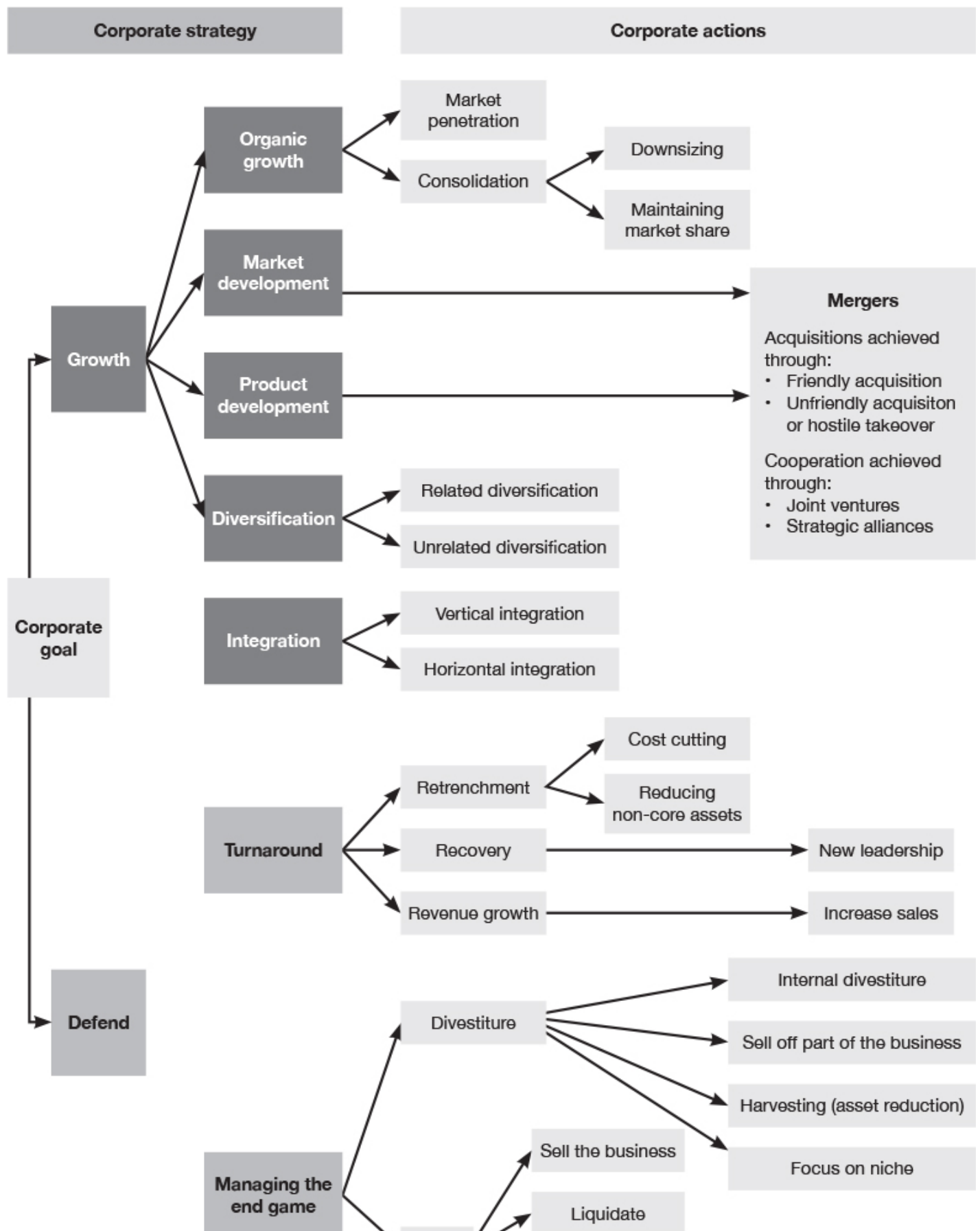
[Figure 10.1](#) shows the corporate strategies and the strategic options. Corporate level strategies can be broadly divided into:

- growth strategies (organic growth and growth through diversification); and
- defensive strategies (retrenchment or recovery, divestiture and liquidation).

Defensive strategies are often also referred to as turnaround or decline strategies, while **cooperative strategies** are also referred to as corporate combination strategies. Cooperative strategies (**joint ventures**, consortia and strategic alliances) are sometimes seen as a third type of corporate strategy. However, we position cooperative strategic options within the corporate growth strategies.

The choice of strategy depends on the strategic fit between the organisation’s internal strengths, capabilities and resources, and the external opportunities. Corporate level strategy decision-making cannot be considered without also recognising the corporate parent (headquarter) and its stance towards overall organisational purpose.

Figure 10.1 Corporate goals of growth and defend with the corporate strategies and actions





10.3 An overview of corporate strategy options

Following on from [Figure 10.1](#), the next section provides an overview of the corporate strategy options. With multi-business organisations, the corporate parent management team considers the factors that affect the entire business portfolio before making corporate level strategic choices. The Case example on the Naspers Group describes how Naspers matches its experience in mergers and acquisitions with growing its portfolio and investing in new ventures with high growth potential. When an organisation chooses and implements the correct strategy, it can realise above-average returns which will enable the multi-business organisation to maximise wealth and contribute to the survival of the various business units in the long term.

Multi-business organisations' decisions about its corporate strategies flow from its corporate goals: either to grow the business or to defend it when it finds itself in a vulnerable position. Whether opting for growth or defence goals, organisations have various corporate strategies and actions to choose from, as shown in [Figure 10.1](#). Growth strategies are broadly distinguished between internal growth (i.e. growth from within the organisation, such as developing products) or external growth (i.e. growth outside the organisation, such as acquiring another company). The first option is to grow the business organically through market penetration or consolidation. The second option is to grow it either by entering new markets (market development) or by expanding its product range (product development). The third option is to diversify the business, similar to what Naspers and Virgin are doing. Finally, organisations can also opt to grow the business through integration strategies. Diversification and integration strategies are often referred to as external growth strategies. Within growth strategies, organisations can choose from a range of corporate actions to achieve their corporate growth goals. These corporate actions include the cooperative or corporate combination strategic actions that are especially appropriate for organisations that operate globally or in technology-driven industries.

When the organisation finds itself in a vulnerable position due to new competitors, an increase in existing competitive rivalry or an internal organisational weakness, multi-business organisations will opt for defence strategies. The defensive strategy options include turnaround strategies or strategies to manage the end game (i.e. divesting or exiting the market).

10.4 Growth strategies

Growth strategies are viable when opportunities exist and the organisation is in a position to exploit them. As [Figure 10.1](#) indicates, growth strategies can be divided into organic growth such as market penetration, and market development, product development and innovation. Growth strategies can also be divided into external growth strategies such as diversification and integration. Diversification strategies are further divided into related diversification (also referred to as concentric) or unrelated diversification (also referred to as conglomerate).

Organisations seek growth for a range of reasons. For many, expansion boosts profitability and business valuation. Others opt for growth strategies as this improves their competitive position. Some organisations merge with other organisations to tap new markets or to expand their market reach, which is an external growth strategic action. See the Case example *Bidvest expands Commercial Products division through Brandcorp acquisition* on the next page. Others leverage existing technologies into fresh markets, lowering costs – this refers to internal growth strategies like market development. Growth may also help secure a presence in burgeoning markets such as the BRIC countries (Brazil, Russia, India and China). However, irrationally, some organisations grow to indulge managerial egos or to boost executive compensation whenever pay is linked to organisational size. Some may argue

that the retail company, Steinhoff International, pursued growth beyond its ability with its aggressive acquisitions outside South Africa.¹⁶ Pursuing a growth strategy only makes sense if it is linked to corporate goals. The criteria for evaluating strategies were discussed in [Chapter 8](#), and management egotism is not a viable criterion for consideration.

Growth strategies also pose some problems that the strategic decision-makers need to consider. When pursuing a growth strategy, the overall control of the business may be diluted and mismanaged. It is possible to compromise flexibility if funds and other resources are overcommitted. Organisational bureaucracy and higher overhead costs may plague the potential benefits that such a growth strategy offers.

CASE EXAMPLE: Bidvest expands Commercial Products division through Brandcorp acquisition¹⁷

JSE-listed Bidvest has acquired industrial and consumer products supplier Brandcorp from Ethos Private Equity for an undisclosed amount.

In a statement released on Friday, Bidvest said the acquisition presented an attractive investment opportunity that was aligned with Bidvest's strategy of expanding its business operations through value-accretive acquisitions. The acquisition would enable Bidvest to add niche industrial and consumer products, including the Cellini brand, into its portfolio.

Brandcorp would be included in the Bidvest Commercial Products (BCP) division, which already comprises various industrial and consumer businesses such as G.Fox, Plumblink, Home of Living Brands, Berzacks, Yamaha and Academy Brushware.

'The acquisition of Brandcorp allows us to add scale to BCP, as well as [providing] access to an existing client base that can be leveraged for synergies and other possible opportunities across the Bidvest group. Brandcorp brings strong, well-known and niche brand offerings into Bidvest, which are difficult to replicate in this market. There is a natural fit between our two companies as we have similar decentralised management operating models and in instances our product offerings and customer base is complementary,' commented Bidvest CEO Lindsay Ralphs.

Ethos Fund V acquired Brandcorp in 2007 with the intention of strategically repositioning the company.

Brandcorp has since made strategic acquisitions, including that of Renttech and Burncrete; introduced a black economic-empowerment shareholding; expanded its warehouse capacity; enhanced its management; and undertaken a comprehensive strategic review of the business.

Ethos also recapitalised Brandcorp through a R750 million high-yield bond placement in 2010.

'Such initiatives reaffirm Ethos' ability to identify attractive opportunities and work with management teams to create long-term value that is predominantly derived from earnings and revenue outperformance. Our ability to grow companies, even during challenging times, has made Ethos the partner of choice for successful management teams who have a desire to explore corporate change and growth,' commented Ethos partner Shaun Zagnoev.¹⁸

Many organisations aim to grow their businesses, yet many fail to achieve their growth targets. When organisations have clear corporate goals and accompanying growth strategies, their chances for successful growth are improved. Organisations can opt to grow their portfolio of businesses through various strategies, as alluded to earlier. When corporate parents, or the strategic team in the case of a single-business organisation, want to grow market share, they will choose from a range of corporate growth strategies and actions. The following section describes the corporate growth strategies. We suggest you refer to [Figure 10.1](#) while working through the sections that follow.

10.4.1 Organic growth strategies

Organic growth strategies focus on growth in the internal environment of the organisation and are discussed in detail below.

10.4.1.1 Concentrated growth or market penetration

The first option for an organic growth strategy is concentrated growth or **market penetration**. Some authors also refer to it as internal growth (growth from within) or intensive growth. With this type of strategy, the aim is to remain within the organisation's current range of products or services while attempting to attract customers from directly competing products. The starting point of this strategy is existing customers, as retaining them is cheaper than attracting new ones.

Market penetration is a viable option if the market is growing because existing customer loyalties may be less secure, and new customers entering the market may still be searching for the most acceptable product. With the launch of Virgin Mobile in South Africa in 2007, Vodacom launched an aggressive marketing campaign to attract new customers in the existing market. This is a prime example of a concentrated growth strategy. **Market penetration strategies** have a high rate of success with low risk as the organisation's product and marketing skills are concentrated on specialised products and concentrated markets. Another example of a company that has successfully grown its business through market penetration is Kellogg, the multinational food manufacturing company known for its breakfast cereals. Kellogg entered the South African market in 1923 and opened a manufacturing plant in Springs, South Africa in 1948.¹⁹ Kellogg offers an extensive product line of differentiated brands designed to appeal to specific market segments. For example, Kellogg targets the health- and weight-conscious female market segment with Special K, and children with the Rice Krispies brand. In line with an innovation strategy, Kellogg periodically has new additions, such as the Special K Red Berries cereal or cereal bars.

10.4.1.2 Consolidation

When an organisation follows a **consolidation strategy**, its focus is on maintaining its market share in existing markets with its existing products. It is important to realise that consolidation does not mean that the organisation takes no action at all – the market environment is constantly changing and may force the organisation to reshape or innovate to improve the value of its products or services.

Consolidation may take two forms, namely reshaping through downsizing or maintaining market share. Reshaping may require the organisation to withdraw or downsize. One of the key determinants of a consolidation strategy is the product life cycle. Even if demand for the organisation's product is strong, the ability to compete profitably will change through the different stages of the life cycle. Organisations that have a high market share are in a better position than their competitors to maintain market share. High-market-share organisations may benefit from economies of scale that lead to improved purchase or sales turnover, and research and development (R&D) or sales ratios. These organisations are often able to spend more on R&D, which may lead to the development of strategies of higher price or higher quality compared to low-market-share competitors. Gaining and maintaining market share during the growth phase of the product life cycle leads to benefits during the maturity phase.

10.4.2 Market development

Another form of a growth strategy is to explore new markets with the aim of meeting needs with current products. For example, South African beer and other products have found favour in African markets and abroad. Retail chains such as Shoprite, Checkers and OK have become household names in South African homes. The Botswana retail chain, Choppies, opened several stores in the North West province in South Africa. This is an important source of opportunity. RCL Foods,²⁰ a leading African food producer, started as a small family-owned business, and now operates in South Africa, Uganda, Zambia, Swaziland, Namibia and Botswana. RCL continues to offer the same line of products, but to different markets.

A **market development strategy** is an option in a situation where there are limited opportunities in the current market segments. One of the market development options is thus to develop new uses for existing products. This strategy increased the rate of use by an organisation's own market, and attracted customers from its rivals. Another option is to spread the existing product over new geographic areas, as is the case with RCL Foods mentioned above. Another example is when the South African cellular phone provider MTN made substantial inroads into the rest of Africa, predominantly in Nigeria and Uganda, and other countries. The South African parastatal Eskom has also moved across the African continent. Geographic spread also refers to entering new regions in the same country, such as Mango, the airline that took over the Johannesburg to Port Elizabeth route when rival 1time exited the industry. Another example of a market development strategy is in the South African retail industry. Walmart, the American mass retailer, entered the South African retail industry. H&M, the Swedish retailer, entered the South African market in 2015 and placed pressure on South African fashion retailers. The H&M entry was followed by other global brands like Australia's Cotton On, Spain's Zara and the UK's Topshop.

Market development is a suitable strategy when new channels of distribution are available that are reliable and of good quality. Organisations that are very successful in a specific line of business may find it easier to explore different markets, such as Burger King's launch in Cape Town in May 2013. Burger King is the world's second-largest hamburger chain and has successfully ventured into international markets. Market development is also a viable option when an organisation has the needed capital, expertise and resources to manage expanded operations. An example of market development is in the retail clothing industry. During 2012, the Foschini Group acquired the luxury menswear brand, Fabiani. This strategy gave Foschini entry to the high-end customer segment where they did not operate previously.²¹

10.4.3 Product development

Over and above penetrating markets, maintaining existing market share and developing new markets, the strategic decision-makers may also consider modifying existing products and/or pioneering new ones. **Product development** is where organisations deliver modified or new products to existing markets. This usually involves large R&D budgets and can be a costly strategy. When existing products of organisations are in their maturity stage, this often prompts strategic decision-makers to explore product development or offer an improved product. The rationale is to attract satisfied customers to try new products as a result of their positive experiences with the organisation's existing products. A **product development strategy** often goes hand in hand with investments in research, development and innovation. A good example is Waymo – a subsidiary of Google's parent company Alphabet Inc. Waymo began as a the Google self-driving car project in 2009 and is now an independent self-driving technology company with a mission to make it safe and easy for people to get around – without a driver.²²

Another example of reaching an existing and established market is found in the Foschini Group and its introduction of cellphones in its Totalsports, Sportscene and DueSouth stores, which led to an increase in turnover. Product development is a viable option for organisations competing in high-growth industries.

New products seek to replace outmoded versions or to reach new prospects. A product line is often extended to draw in new segments. This is exemplified by motor manufacturers who introduce a hybrid range of vehicles to their existing product line. As customers are becoming more environmentally conscious, and the natural resources are depleting, motor manufacturers are investing in product development to cater for these changes.

It is important to develop products to meet customers' expectations – it does not make business sense to do so to such an extent that customers become disinterested with the product modifications and choose to buy a competing product with fewer modifications. For example, many cellular phone manufacturers add so many new features that in the process they lose its ease of use, possibly causing customers to switch to a more user-friendly product with fewer features.

In some cases, following a product development strategy may require an organisation to develop new capabilities. As a strategy, product development can entice new consumers while retaining existing ones. Also, organisations may be forced to develop their products because the consequences of not developing new products could be unacceptable. In these cases, performance may become poor in relation to that of competitive products.

10.4.4 Diversification strategies

An organisation may add new businesses to its current portfolio through diversification or external growth. A diversified business is synonymous with a multi-business organisation operating in two or more industries. Examples of diversification include new products in new markets, and franchising. Diversification strategies may also involve organisations or activities that are indirectly related or unrelated.

The main aim of diversification strategies is to secure additional market share that may lead to increased power and, ideally, improved profitability. It is important to realise that even when an organisation is not overdiversified, a high level of diversification may be risky and may negatively affect the organisation's long-term performance.

Diversification strategies are divided into the following options:

- Related diversification
- Unrelated diversification.

10.4.4.1 Related diversification

An organisation seeking new opportunities in linked industries engages in related or concentric diversification. Relatedness may be in terms of the market or industry as well as the strategic assets – for example, a motor manufacturer may purchase a spare-parts dealer or a service provider. Related diversification is when the new business is related to the existing one. For instance, Naspers, as discussed above, is a great example of related diversification, starting as it did as a printer and publisher of newspapers and magazines, diversifying into book publishing, and then incorporating pay television during the 1980s, followed by internet platforms.²³ One of the benefits of related diversification is the existing expertise and knowledge about the market, the competitors and the overall industry. When an organisation chooses to grow its business through related diversification, it could benefit from economies of scale and scope. The Opening case study *Super Group – complementary acquisitions key to its success* illustrated the Super Group portfolio within logistics – ranging from vehicle dealership to bulk haulage to fleet management. These related businesses increase Super Group's presence in the market and allow for shared activities in the value chain, such as transferring capabilities and competencies from one part of the group to another.

Linked to the strategic option of acquisitions, organisations can also consider greenfield ventures. A **greenfield venture strategy** is appropriate when an organisation aims to create subsidiary businesses in foreign markets. A great example of a greenfield venture strategy is from Hyundai Motor Company, the South Korean multinational automotive manufacturer with manufacturing plants outside Korea. During 2006, Hyundai announced that it would set up one in the Czech Republic and by 2017 it had produced 357 000 cars.²⁴ This greenfield venture strategy held benefits not only for Hyundai but also for the Czech Republic and its people.

As South Africa has opened up to the world, investors have ventured aggressively into the rest of Africa and across the world. Another example of an organisation following a growth strategy is MTN. This organisation has been far more aggressive in entering emerging markets than its rival, Vodacom. MTN is active in, among others, Nigeria, Iran, Ghana, Ivory Coast, Cameroon, Uganda, Sudan, Syria and Botswana. In fact, with a subscriber base of 232.5 million, 79% of MTN's revenue is generated outside South Africa.²⁵ The MTN group structure indicates how MTN's interests outside South Africa form key pillars of its business model, enabling more focused management and better execution of strategies across the various business units in support of MTN's growth goals.

Another example of a growth strategy through related diversification can be found in the banking industry. In 2007, Standard Bank secured a controlling stake in Nigeria's IBTC Chartered Bank Plc. The strategic decision-makers at Standard Bank would have considered diversification into Nigeria a viable option as Nigeria is the most populous country and largest oil producer in Africa with significant potential to be a leading player on the African continent.²⁶

The Opening case study on Super Group describes how Super Group expanded its business when it acquired businesses the bulk dry powder and liquids distribution business and then later in the dry bulk goods hauling market.

A **related diversification strategy** is a viable strategy option when the industry is in a slow growth stage and where the objective is to increase sales in a particular market by increasing the number of products consumed by each individual customer. For example, Absa followed a related diversification strategy when it introduced short-term insurance, life insurance and funeral packages in addition to its normal banking services. This strategy opened the door to Absa's existing customers to bring more of their business and money to Absa.

10.4.4.2 Unrelated diversification

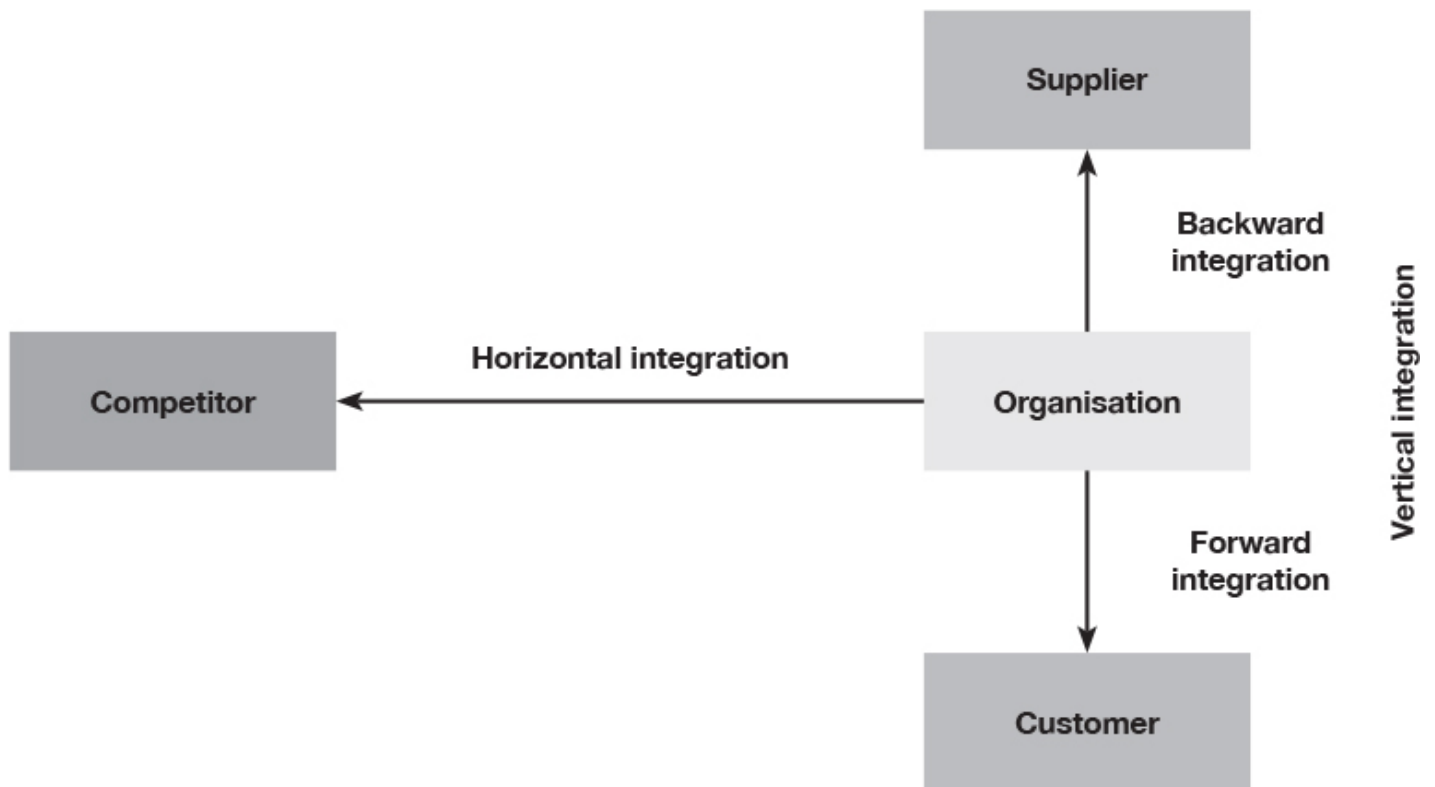
When the strategic decision-makers choose to take the organisation into an entirely new territory, it follows an unrelated or conglomerate diversification strategy. Value can also be added through unrelated diversification by using expertise and resources in one line of business to enter into an unrelated line of business. During 2018, Discovery launched Discovery Bank. The plans for a retail bank by Discovery were already shared in 2015. This move of Discovery introduces a bank in direct competition with Absa, FNB, Capitec, Nedbank and Standard Bank. Diversifying into retail banking builds on Discovery's existing credit card business, with around 300 000 active clients in 2017.²⁷ This growth strategy promises to extend the Discovery Group's existing market share and footprint in the financial services sector. When one compares where Discovery started as a medical aid to where it is now as a financial services provider, one can see how this organisation made the most of unrelated diversification from medical aid into banking.

An **unrelated diversification strategy** is a viable strategy option when the basic industry of the organisation is experiencing declining sales and profits, or the organisation has the capital and managerial talent to compete successfully in a new industry. Organisations that diversify too much will risk increased transaction and bureaucratic costs, and additional managerial complexity. The diversified multi-business organisation is more complex to manage. The role of the corporate parent increases in importance as the complexity of the business operations increases because of the diversification strategy.

10.4.5 Integration strategies

Organisations often acquire other enterprises similar to their business. Growth through integration may occur through the acquisition and amalgamation of competitors (horizontal integration), or suppliers or distributors (vertical integration). [Figure 10.2](#) depicts these integration options.

Figure 10.2 Integration strategies



Vertical integration may entail expansion into the supply of an organisation's inputs – this is called **backward vertical integration**. **Forward vertical integration** entails expansion into the distribution of its outputs. Integration strategies involve organisations at different stages of the production or distribution chain. For example, should a steakhouse chain purchase a cattle ranch (i.e. one of its inputs), this would represent backward integration. Forward integration would occur if a book publisher bought a chain of book stores to distribute its own (and others') products. Another example is when clothing brand Jeep opened its chain of stores – previously, Jeep had sold its merchandise through retailers such as Edgars. Nowadays, one can purchase a limited range of Jeep clothing in retail stores, and a wider range at the Jeep store itself. This is an example of a growth strategy aimed at reaching customers and potential customers directly. Another means of implementing forward vertical integration is through franchising. Car manufacturers like Volkswagen or Audi integrate more closely with the customer through franchised dealerships that only stock their range of vehicles. These dealerships promote the vehicles through local media and marketing campaigns. The strategic decision-makers will consider forward integration as a viable strategic option when the organisation's present suppliers or distributors are especially expensive or unreliable. Instead of sharing retail space in Edgars with competing brands, Jeep clothing is now sold through direct stores staffed with experts who have direct links with the manufacturer. Forward vertical integration also offers the organisation the benefit of cutting out the retailer who may have a high profit margin. If the organisation can profitably distribute its own products with competitive prices, then forward integration is a viable option.

As depicted in [Figure 10.2](#), backward vertical integration takes the organisation closer to its suppliers. It is a strategy aimed at gaining ownership or more control over suppliers. This strategy is especially viable when the current suppliers are unreliable, too expensive or not able to meet the organisation's needs. For example, Anheuser-Busch InBev SA/NV, an American brewing company that acquired SABMiller, is investing in agricultural development in South Africa in order to increase hops production.²⁸ This integration strategy ensures a steady supply of hops for brewing. One of the benefits of backward vertical integration is that the organisation is not subject to unreliable delivery from the supplier and is not affected by the suppliers' high profit margins.

Horizontal integration, as depicted in [Figure 10.2](#), aims to increase market share through merging with or acquiring another organisation. One example that many may be familiar with is Facebook's acquisition of Instagram.²⁹ Both social media organisations operate in the same industry and share similar technologies in photo-sharing services. By acquiring Instagram, Facebook not only eliminated a competitor, but also acquired the technology and expertise. This move made Facebook the dominant player in social media photo-sharing services.

Acquisition entails purchasing the assets and skills of a takeover target. The form of purchase may vary, and one option is for an acquiring organisation to use its cash reserves identified through the internal environmental analysis to purchase a target organisation. Another purchase option is to go into debt to buy the target organisation. The organisation may also use its own equity to purchase the target organisation.

The purchase transaction itself can also take several forms. The acquiring organisation may purchase all or a majority of the target organisation's assets, or a controlling share of them.

Acquisitions are divided into two forms – friendly or unfriendly. A friendly takeover occurs when the management of the target organisation wants its organisation to be acquired. For example, in 2008 Tata Motors acquired Jaguar Land Rover for \$2.5 billion (R20 billion). Many economists thought that the acquisition of the money-losing British operation was an unnecessary burden for Tata. Since the acquisition, Tata has been working on turning Jaguar Land Rover around with plans to launch several new vehicles, including a hybrid or electric version of its models.³⁰ The Tata acquisition of Jaguar Land Rover translated into new opportunities and a better product mix.

An **unfriendly takeover** occurs when the management of the target organisation does not want its organisation to be acquired. Unfriendly acquisitions are also known as hostile takeovers. During March 2013, the Bidvest Group made an unsolicited bid for 60% of Adcock Ingram, South Africa's second-largest pharmaceutical company. Bidvest was likely attracted by Adcock's cash-generating potential and this bid was in line with Bidvest's growth strategies.³¹ During 2015, South Africa's largest private education group, Curro Holdings, made a bid for rival Advtech. Curro Holdings attempted a hostile takeover to create an education company valued at more than R18.6 billion.³² After an initial attempt, however, Curro dropped its bid in the same year.

The Opening case study on Super Group described the range of acquisitions from 2009. These enabled Super Group to enter new markets – within South Africa and in Europe, the UK and New Zealand. Acquisitions or mergers enable organisations to enter new markets or segments at short notice. The Case example *Bidvest expands Commercial Products division through Brandcorp acquisition* describes the Bidvest acquisition of Brandcorp. An example that illustrates that regulatory involvement may form part of a potential merger transaction is found in the proposed merger between SA Airlink and Safair operations. During February 2018, the Competition Commission prohibited the proposed merger as the transaction was likely to result in a substantial prevention of competition.³³

Reasons for acquisitions include the attempt to increase market power which is usually derived from the size of the organisation, and its resources and capabilities to compete.

Other reasons why a takeover organisation may consider merging with or acquiring another one include possible tax advantages or to eliminate inefficient management at the target organisation. It may also consider mergers or acquisitions to adopt more efficient production or organisational technology. The two organisations, compatible in terms of technology, skills, brands, products or markets, combine complementary core competencies and resources to achieve synergy.³⁴ They are said to enjoy strategic fit. During February 2014, Facebook acquired WhatsApp for \$19 billion – Facebook and WhatsApp³⁵ have complementary offerings and markets, and the strategic fit is clear. During 2017, the locally produced craft beer, Soweto Gold, was bought by brewing giant, Heineken.³⁶ Earlier in 2017, Heineken also bought Stellenbrau, a South African craft brewery. This acquisition seems to make business sense as the strategic fit is clear. Local press quoted Heineken South Africa managing director Ruud van den Eijnden as saying that Stellenbrau offers a natural fit with Heineken with shared values – a love of and pride in producing great beer and an entrepreneurial spirit. 'Heineken wants Stellenbrau to keep doing what it does best, as the group

has no plans to “corporatise” the brewery. If we combine forces, we can do so much more together. The best thing you can do for us is to keep your identity. We can learn as much from you as you can from us.’³⁷

10.4.6 Cooperative or corporate combination strategies

In a global economy where competitive pressure increases daily, **cooperative** strategies enable different organisations to form partnerships to share resources, capabilities or technical knowhow to build a competitive advantage. Cooperative strategic options form part of the corporate growth strategies of organisations. Within the corporate growth strategies, organisations can opt for cooperation or corporate combination strategies. Cooperation strategies relate to situations where organisations join hands with rivals for mutual benefit. Cooperation strategies achieve similar ends as acquisitions or mergers, but without the heavy investment. These strategies may involve the outsourcing of short-term contracts, joint ventures, strategic alliances or licensing agreements. When an organisation does not or cannot possess all the resources and capabilities needed to achieve its strategic objectives, then cooperation strategies become logical options. The value of one organisation’s product or service is enhanced through the existence of the other organisation’s product or service. It is necessary to recognise at this point that these cooperative or corporate combination strategies can also be seen as vehicles to carry out corporate strategies. Often these cooperative strategies are used for corporate expansion and not necessarily corporate strategies on their own.

10.4.6.1 Joint ventures

A **joint venture** is the creation of a new organisation owned by two or more partners. Most joint ventures involve two partners. They are typically formed to exploit opportunities in areas that co-owners find attractive but which, for various reasons, neither wants, nor is able, to develop individually. The project may simply be too big or too complex for one organisation. Projects such as dams and other mega-sized construction projects invite joint ventures or consortia.

Alternatively, the opportunity is not core to either party so that only a joint effort will attract the partners. An organisation seldom invites outsiders to share in its core projects.

Joint ventures also feature in new industries and technologies requiring a multiplicity of skills and other resources that no one organisation possesses. This is the case, for example, in the development of new fuel technologies where otherwise fierce motoring rivals cooperate. The technology industry offers many examples of joint ventures, such as those between Tesla and Panasonic. They have been strategic partners for several years, with Panasonic supplying the batteries for Tesla’s vehicles from its overseas factories and then with the construction of Gigafactory 1.³⁸

In a joint venture strategy, two or more organisations create an independent organisation that shares some of its resources and capabilities to develop a competitive advantage. A joint venture does not imply a change in shares or ownership. For example, Isuzu Truck South Africa (Pty) Ltd is the result of a joint venture between General Motors South Africa and Isuzu Motors Japan.³⁹ The joint venture between diamond company De Beers and listed mining company AngloGold Ashanti involved an agreement to explore the mining of minerals from deposits located on the continental shelf. The establishment of this joint venture allowed AngloGold Ashanti to take first-mover advantage of the opportunity of partnering with a world leader in the field of marine exploration and mining with a view to targeting minerals from mineral deposits located on the continental shelf.⁴⁰ A more recent example is Netcare’s R1.3 billion acquisition of Akeso Clinics. Netcare is South Africa’s second-largest private hospital firm and it received the go-ahead in March 2018 from the Competition Tribunal to acquire a chain of psychiatric health facilities under Akeso Clinics.⁴¹ An example of a joint venture in the hospitality industry is that between Regent Hotels & Resorts and the InterContinental Hotel Group (IHG). Under this joint venture, the Regent properties are joined with the IHG global online reservation system and loyalty programme, which promises to accelerate the growth of both sales

and profits. This mutually beneficial venture allows Regent to streamline its growth and offers IHG development in the fast-growing luxury segment.⁴²

Finally, joint ventures may be the logical avenue into countries such as China that require them for incoming investors. The Case example *PSA announces car-making joint venture in Namibia* describes how the French automotive manufacturer known for the Peugeot brand gained entry into the Namibian automotive industry through a joint venture strategy.

Joint ventures leapfrog border restrictions, permitting an organisation to gain a foothold in foreign markets. They also lower business risk by partnering with local entrepreneurs who have knowledge, contacts and experience of the domestic market.

Joint ventures do have limitations, not least the division of responsibilities, rights, control and benefit sharing. Conflicts surround operational and policy issues. Initially, however, joint ventures may be beneficial and inescapable.

CASE EXAMPLE: PSA announces car-making joint venture in Namibia⁴³

PSA Group and the government of Namibia signed an investment agreement facilitating the joint venture between the French automaker and the Namibia Development Corp to assemble Opel and Peugeot vehicles in the southwest African country.

The joint venture is set to launch in the second half of 2018 at a facility in Walvis Bay on the Atlantic Ocean. Annual volume is targeted at 5 000 units, with the initial products being the Opel Grandland X and Peugeot 3008. Other products will follow to meet consumer demand in the five countries comprising the South African Custom Union. The agreement is part of PSA's 'Push to Pass' growth strategy that aims to satisfy customer expectations in all the regions in which the automaker operates.

Part of that plan calls for directly producing within the Middle East and Africa 70% of the vehicles sold in those regions. The announcement also comes less than four months after Opel announced a separate strategy called Pace, which aims to make the former General Motors subsidiary and its Vauxhall sister brand profitable by 2020.

10.4.6.2 Strategic alliances

Strategic alliances are based on commercial collaborations where organisations form partnerships in order to achieve shared goals for a defined period. A contract is signed under which partners provide reciprocal services or facilities. Organisations share the costs, risks and benefits of the business opportunity. An advantage is that companies remain separate and independent, with low bureaucratic costs.

Unlike joint ventures, stock ownership is not essential to a strategic alliance although it can be should the partners so decide. Like joint ventures, strategic alliances allow partnering organisations to group capital, resources, facilities and expertise in an effort to reduce costs and to respond more rapidly to other competitive forces. One partnering organisation may, for example, provide factory space, while the other contributes shelf space. Thus alliances and partnerships build critical mass and provide group security.

Another example of a strategic alliance is the one between Toyota, Peugeot and Citroen with the production of their small city cars or 'micro cars'. The Toyota Aygo, the Citroen C1 and the Peugeot 107 share most of their interior components. The Czech components manufacturer Peguform Bohemia persuaded Toyota to outsource the production of its major components such as dashboards and bumpers, and use Saudi Basic Industries Corporation (SANBIC) materials in the production of these components. Peguform Bohemia's decision to align with SANBIC on this project was based on SABIC's experience, dedication, technical support, excellent portfolio and competitive prices.⁴⁴ A strategic alliance involves more than one organisation, but the parties do not take ownership of one another. These partnerships exist for a limited period of time. For example, as cyber-threats become a reality across the world, global audit and advisory firm BDO opted to strengthen its cyber-security capabilities through a strategic

alliance with Panda Security. This strategic alliance allows BDO access to technology (Adaptive Defence) developed by Panda Security.⁴⁵

Increasingly, the face of competition is changing with a trend towards co-opetition. The airline industry, for example, is characterised by networks that share booking and marketing facilities (code-sharing). A case in point is South African Airways that boasts alliances with Lufthansa, Air France, British Midland, Cathay Pacific, Delta Airlines, El Al, Emirates, Thai Airways, Varig, Quantas and others, enabling it to 'serve over 500 destinations'.⁴⁶

What needs to be noted is the need for careful selection of a strategic alliance partner. The alliance partner needs to offer complementary skills and assets, and be prepared to share costs. Strategic alliances require mutual trust, and managing the alliance is an organisational capability that develops over time, experience and learning.

10.5 Defensive strategies

Multi-business organisations may find themselves, or some of their business units, in a vulnerable position where they need to make decisions about the future of those business units. The strategic decision-makers have several strategic options to consider when a business unit no longer meets the objectives set for it by its stakeholders, or if it produces outputs that are no longer desired or required. Defensive strategies are not only considered in cases of business failure, but also when industries are in a decline and the growth and financial sustainability prospects for those organisations or business units competing in that industry are low. **Defensive strategies** also apply to organisations or business units that have potential but have suffered setbacks in recent times. The emphasis of a defensive strategy is on speed of change, and rapid cost reduction and/or revenue generation. Defensive strategies usually have short time horizons and are designed to yield immediate returns.

Figure 10.1 indicates that defensive strategies are divided into two groups:

- Turnaround
- Managing the end game.

When the failure or the decline of the business unit reaches a certain level, or continues for a certain length of time, the organisation has no option but to consider remedial action, either by turning the business unit around or managing the end game and preparing it to exit the market. Remedial action can be through improved marketing effectiveness and competitiveness, or better management of the organisation to reduce costs. Another form of remedial action can be to withdraw from a specific industry or appointing a new management team in the hope that the new strategic leaders will turn the business around. Poor strategic leadership, insufficient financial control, recession, inefficiency and non-competitiveness are generally factors that spur turnaround strategies.

Defensive strategies aim to transform organisations into more potent competitors. Defensive strategies provide the organisation with a second chance, provided that the strategic management team and major shareholders believe that the business has positive long-term potential. Defensive strategies also offer the option of removing the struggling business units from the corporate portfolio. During 2016, local technology group Altron announced that it planned to sell the subscribed base of Autopage – a division that sells phone contracts on South Africa's major mobile networks. The decision was informed by the ongoing mobile termination rate reductions and continued industry and consumer deflationary pressures.⁴⁷ At the time, the CEO, Boyd Chislett, explained that the decision to sell Autopage was in the interest of protecting shareholder value at a time when some of the opportunities started dissipating.⁴⁸

Opting for a defensive strategy is not indicative of business failure. In the Autopage example above, the parent company, Altron, looked at Autopage very carefully and felt it would be better served by exiting the business and investing the gains in other areas.⁴⁹ Altron continues to operate in the telecommunications, multimedia, information technology and power electronics industries. Another corporate action that forms part of the

divestiture strategies is to sell off part of the business. For example, SABMiller Africa sold their 20% stake in Kenya Breweries in 2011⁵⁰ in order to refocus on other, more viable markets.

An organisation subjected to years of hardship will need rejuvenation before it can grow again. Recession, inefficiency and non-competitiveness are customary factors spurring turnaround. If an organisation finds itself in a situation where a turnaround strategy is the only viable option, the strategic decision-makers need to prioritise the factors that give quick and significant improvements. Defensive strategies are aimed at transforming organisations into more potent competitors. The efforts to defend can be based on improved productivity, quality or competitiveness. The most successful turnaround strategies focus more on reducing direct operational costs and improving productivity gains. Whereas turnaround strategies are aimed at internal efforts in turning the business around to be more profitable, managing the end game strategies are aimed at withdrawing investment in some business units or exiting the market altogether.

When considering a defensive strategy, the strategic decision-makers have several options. The first type of defensive strategies is called **turnaround** and is divided into retrenchment, recovery and revenue growth.

STRATEGY IN ACTION: Edcon – turning things around



Edcon is the largest non-food retailer in South Africa and has been in operation for more than 80 years. Edcon offers over 1 100 stores⁵¹ and operates across South Africa, Namibia, Botswana, Lesotho, Swaziland, Mozambique, Ghana, Zimbabwe and Zambia. As a retail group, their portfolio spans over four principal brands: Edgars, Jet, CNA and Thank U. Each of these brands targets a different group of customers.

The South African retail industry is experiencing a number of challenges – one of which is the dividend drop and vacancies in the retail property sector. More and more retailers are forced to downsize or put extension plans on hold while trying to cope with tougher trading conditions.⁵² During 2017, Stuttafords closed down and some argue this was the beginning of the end for retailers that are not adapting to changing customer needs and buying behaviour. In response to these tough trading conditions, Edcon announced a recovery plan that included closing down chains like Red Square cosmetics, Boardmans and La Senza.⁵³ However, Edcon Holdings confirmed that CNA will stay – despite claims that CNA is in a terminal decline.⁵⁴ The market expects Edcon to reduce its South African footprint by a third, potentially closing up to 500 000 m² of retail space over the next 12–18 months.⁵⁵ Edcon has also ended its international joint venture agreements with some of the House of Busby stores such as Mango, Nine West and River Island.⁵⁶ Yet Edcon is betting its future on the old department store format by going back to the basics and focusing on the original 89-year-old department store format of Edgars.

Questions:

In addition to the information provided above, use the internet to gather more facts on Edcon and the South African retail industry. Answer the following questions:

1. Comment on the conditions that lead to defensive strategies. Use examples from the South African retail industry to support your answer.
2. Do you think Edcon's decision to reintroduce the old department store format is appropriate? Why or why not?
3. Consider the growth in online retailers. How do they compare to the traditional brick-and-mortar retailers in terms of corporate strategies?

10.5.1 Turnaround

10.5.1.1 Retrenchment

Retrenchment is a strategy that takes remedial action in response to prolonged deterioration among business units. It takes two forms, namely **cost cutting** and reducing non-core assets.

Cost cutting

This is a popular strategy in the absence of, or in conjunction with, revenue growth. It is also referred to as **downsizing**. This form of turnaround strategy is an intentional, proactive management strategy to reduce the number of an organisation's employees or operating units in the multi-business organisation. Reducing the number of employees does not mean the elimination of key employees from the primary business processes because such action can result in the loss of a core competency. As such, the business units that are not feasible for long-term competitiveness will be the ones considered for turnaround. Options to reduce costs include removing non-essential items or improving productivity through automation. Mango reduced their operating costs by using fuel-efficient aircraft. Organisations may also choose to postpone projects or infrastructure upgrades. Organisations can also opt to establish factories in low-wage-settlement countries like India or the Philippines in an effort to curb their costs. Another option to reduce costs is to lease equipment rather than to buy it. An unpopular option is to freeze salaries or reduce perks of staff members. During 2017, Pick n Pay decided not to pay bonuses to its executives. This decision, which was the result of poor turnover growth and failure to meet working capital targets,⁵⁷ follows in the footsteps of others. During 2013, Maria Ramos, CEO of Absa, announced that she would forego her bonus because the bank published disappointing results. During 2012, Absa paid out 23% less in bonuses and decreased its staff costs by 4% during that year.

Reducing non-core assets

Reducing non-core assets involves selling vacant land, equipment and buildings. However, this may happen even among companies not turning their operations around in an effort to function more efficiently. This form of turnaround strategy helps the organisation to focus on its core businesses. For example, the US parent, General Motors, considered the sale of the Hummer vehicle brand in an attempt to raise cash and cut costs.

By refocusing on the core business, the strategic decision-makers can manage more effectively. Because the organisation is less diversified, the management team can better understand and manage the remaining business units. The cash-strapped construction firm Basil Read entered the second stage of its turnaround strategy in January 2018. Growth in the construction industry had tapered off and the market remained competitive, which forced the organisation to enter into turnaround strategies and to focus on the areas where it is competitive and has the skills. The first course of action in the turnaround attempt was to dispose of non-core assets,⁵⁸ which would yield about R150 million, offering more liquidity to the listed construction group.⁵⁹ The case example on the following page is an example of such a shedding.

CASE EXAMPLE: Selling non-core assets⁶⁰

The business environment offers many examples of shedding non-core assets as part of business turnaround. During 2018, Ascendis Health, a South African healthcare provider that generates the bulk of its profits outside South Africa, announced the selling of its sports nutrition business, its direct selling and network marketing business as well as a production plant in Johannesburg. During May 2019, Ascendis sold its three businesses within its biosciences division to a consortium for R480 million. Ascendis sold Efekto, Marltons and Afrikelp after a strategic review that determined the Bioscience division as noncore to the groups' strategy. Another example is Aveng, a construction engineering company, who has during 2018 and 2019, reviewed its strategy and opted to dispose of non-core assets and properties. The proceeds from the sales would be used to strengthen the financial position of the group. More recently, EOH, an IT service management company, opted to sell non-core businesses to generate R1bn to quash its debts.

10.5.1.2 Recovery

When following a **recovery strategy**, the strategic decision-makers attempt to stabilise the business. In this case, the organisational problems are externally induced, and the aim of a recovery strategy is to introduce new entrepreneurial blood in the form of turnaround specialists or a new leadership team, who bring new ideas and explore new opportunities.⁶¹ For example, Avon found itself in a vulnerable position after years of management missteps and a complacent board of directors.⁶² Attempted takeovers and buy-outs haunted the cosmetic company during 2011. Problems with the implementation of Avon's growth plans led to the decision by the board to ask the then CEO, Andrea Jung, to step down. Under Jung's leadership, the door-to-door roots of Avon were not embraced, and Jung wanted Avon to compete with blue-chip consumer packaged-goods companies such as L'Oréal and Procter & Gamble. At that time, analysts painted a picture of a company that was uncertain of what it wanted to be and therefore unsure of how to move forward.⁶³

To illustrate, shifting from a cost-based to a differentiation strategy may raise the profile of product quality and revitalise a product. Internally, the organisation may streamline operations and revisit functional strategies such as marketing and human resources. Some of these could profitably be outsourced. Recovery is therefore a process of nursing a business back to health.



A recovery strategy may not always be successful. In the case of Avon, during 2016 the cosmetic company saw an improvement in its performance with most of its strategic initiatives going according to plan.⁶⁴ However, by 2018 Avon was back in a slump with weak financial performance and its direct selling model losing relevance with the digital revolution in the market space.⁶⁵

10.5.1.3 Revenue growth

There are various ways to grow sales, particularly during a recession. These include dropping prices, increasing promotions, product modifications, more sales staff and attentive customer service. In the short term, products or services that generate cash quickly may be attractive opportunities even if their gross margin is small. Ironically,

additional marketing becomes essential when it is least affordable in order to revive sales. If the strategic decision-makers opt to reduce prices in an effort to sell more products, the marginal costs must at least be covered. For recovery to be sustained, stability must endure. This is accomplished through efficiency continuation and business restructuring. Revenue can also be increased through improving certain management control systems. If stockholding costs and pilferage can be kept to a minimum through a stock management system, then cash is freed.

The second type of defensive strategy is called managing the end game and is divided in divestiture and exit.

10.5.2 Managing the end game

10.5.2.1 Divestiture

The intention of a **divestiture strategy** is to focus on healthier divisions or raising cash rapidly. The corporate strategic actions that can be employed in divestiture strategies are internal divestiture, selling part of the business, harvesting or focusing on a niche. Divestiture may be internal or external. The reasons for opting for internal or external divestiture may be similar, but the main aim is to reallocate the resources saved or generated. Reasons may include declining demand or technological substitution, for example cassette recorders and photographic film. Another reason to consider divestiture may be due to increased foreign competition, for example the textile industry in the Eastern Cape that struggles to compete with Asian competitors, or changes in customer preferences, for example iodised salt versus Maldon salt.

Internal divestiture

Internal divestiture may, for example, entail the closure of a plant as part of a rationalisation programme. Internal divestiture is closely related to reducing non-core assets discussed in [section 10.5.1](#). Divestiture strategies may be considered when organisations want to cut their losses or to raise cash to fund other business units by closing one of their business units.

Selling part of the business

In a multi-business organisation, external divestiture refers to the sale of part of the business. A likely candidate for sale is a business unit that is not performing well or in which the investments required to maintain it are not viable in terms of the potential profits. Another reason why the strategic management team may consider selling a business is if it no longer fits with the strategic direction of the parent organisation. For example, during 2018 Imperial Holdings sold off its automotive business with the establishment of Motus. Essentially, Imperial can now continue its focus on logistics while Motus focuses on its motor business.⁶⁶ Another example is found within Naspers. During 2018, Naspers announced the selling of its Brazilian e-commerce business Buscapé as part of a strategy to focus its portfolio on classifieds, food delivery and financial technology startups, or fintechs.⁶⁷

Harvesting

Divestment may be voluntary and may take the form of **harvesting** a business that lacks synergy or is non-core. Harvesting is also termed asset reduction as the organisation disposes of a subsidiary once it has maximised returns from it. Harvesting is slightly different from selling part of the business – with harvesting referring to the termination of investments into a product, product line or subsidiary. The Virgin Group, known for its diverse portfolio of businesses, invested in a line of soft drinks, which was introduced to the market in 1994. For years the group continued to invest in this, with the Virgin Cola brand competing against Coca-Cola and Pepsi. After 16 years, Virgin Cola ceased to exist. At that time it was clear that the Virgin Group's plans to become a major player in the cola market did not warrant further investment.⁶⁸ hence it harvested the Virgin Cola range. When a corporate parent wants to withdraw from a declining industry, the harvesting option is most appropriate. Another factor to

consider when choosing a business unit for divestiture is the current position in the product life cycle and the likely potential for future growth and profitability.

An example of a **harvesting strategy** can be found in Sasol, a South African integrated energy and chemical company. In 2010, Sasol announced that it would divest five of its fertiliser blending facilities located across the country.⁶⁹ The sale of the five fertiliser blending facilities enabled Sasol Nitro to increase its focus on upstream activities of its fertiliser value chain.⁷⁰

Focus on niche

A multi-business organisation may also redirect its energies into one or more niches. A niche strategy targets segments or 'pockets of demand' that remain promising or better suited to its talents.⁷¹ 'Niching' may also result from a downsizing exercise. However, divestment may be forced by market indifference. Non-core units that no longer fit the corporate profile may be 'spun off' to outsiders or current employees. The latter is termed a management buyout. During 2012, a group of investors led by RMB Ventures and Stockdale Street Ltd completed a management buyout of JoJo Tanks, South Africa's largest provider of containers used to harvest rainwater.⁷² The buyout deal would enable JoJo Tanks to fund its expansion while making a difference to people affected by lack of water security.⁷³

10.5.2.2 Exit

Organisations have three options to exit the industry:

- Sell the business,
- Liquidate the assets of the business; or
- Declare bankruptcy.

Selling the business is considered the best option as an exit strategy because the situation can still be salvaged by the potential buyers. CNA has been around for decades but appears to be in terminal decline, and liquidation may be the best option. Over the years its store base has shrunk from around 200 at the start of the decade to 185. Large flagship stores have been downsized but the profit margins keep falling.⁷⁴ With liquidation, the assets of the business are sold, and shareholders may still get some return. Bankruptcy equates to permanent closure of the business, and creditors are compensated with the sale of the assets.

Selling the business

The strategic decision-makers may decide to exit the market by selling the business as a going concern. An example of such a strategy is in the telecommunications and media industry. Telkom, South Africa's largest telecommunications provider, attempted to venture into the pay-television industry. Initial investments were made and Telkom Media was established. Later, the Telkom management team reconsidered their decision and sold Telkom Media to Shenzhen Media South Africa. Company insiders at Telkom explained at the time that the venture into broadcasting had limited chances of success. The sale of Telkom Media enabled Telkom to remain focused on their core business of telecommunications.⁷⁵ Selling the business may be the last option before a business is formally liquidated.

Liquidation

Liquidation is the ultimate exit strategy. Here, the entire business is sold off either as a whole or in pieces, sometimes by auction, but not as a going concern. With liquidation the management sees no future prospects for the organisation and wants to salvage some value. This is seen as a last resort where the assets are sold, often at a loss. Sometimes the liquidation is prompted by the strategic decision-makers simply wanting to harvest the organisation

and move on. Even where the motive is to cut one's losses, there will usually be buyers who believe that they can acquire the organisation and turn it around, provided the price is low enough. During 2012, the airline 1time filed for liquidation after deciding that business rescue was not viable. All of its operations were grounded after a business rescue practitioner advised the board that there were no reasonable prospects of survival.⁷⁶

Closure/bankruptcy

In the case of **bankruptcy**, where the business can no longer repay its debts, the selling of assets may be dictated by legal requirements. Bankruptcy is considered as business failure. The organisation has no hope of turning its activities around and closes its doors for business. With bankruptcy, all the assets of the organisation are sold for their tangible worth, and the proceeds are then used to compensate creditors. An example of business closure due to bankruptcy can be found in the airline industry: Velvet Sky, a low-cost airline that was established in 2008, was so indebted to creditors by 2012 that it was liquidated and then closed for business.

In the previous section we considered the strategic options available to the owners of a multi-business organisation. However, the management of such organisations is complex and challenging, and more often than not leads to the unnecessary destruction of value. In the next sections we focus on the role of corporate management.

10.6 Managing the multi-business organisation

Managing a multi-business organisation comes with a level of complexity not found in single-line ones. A multi-business organisation needs strategies at corporate level that are formulated in addition to the strategies at the business level. As we know from [Chapter 8](#), strategies at the business level deal with the products or markets. The preceding sections in this chapter confirmed that strategies at the corporate level deal with decisions on what and how many businesses and industries to operate in. Such strategies require careful analysis to ascertain if the requisite resources, competencies and capabilities exist to expand markets. The following section deals with the corporate parent, commonly referred to as the headquarters, and its role in managing the multi-business organisation.

10.6.1 The role of the corporate parent

In its most basic form, corporate strategies seek to define how the organisation will create value in the various business units. A multi-business organisation's strategic decision-makers need to manage the portfolio of its businesses. The basic premise of managing such a portfolio is that competition occurs at the business level and this is where competitive advantage is developed. This means that the organisation's headquarters, or corporate parent, must seek attractive (potentially highly profitable) business opportunities, fit them into the organisation, assess the requirements and allocate strategic resources.

The headquarters of multi-business organisations are often referred to as the corporate parent. Using the analogy of a parent company with several children (the business units) is commonly accepted in the academic and business spheres. Just like a family unit, the relationships between parents and children are complex and often challenging. While many of these businesses (children) exist independently, it is the corporate parent who decides if new business ventures should be entered into, decides on the corporate structure, and defines the budget and capital expenditure. The corporate parent makes the corporate strategic decisions. Often, the corporate parent acts as an intermediary that influences the decisions and strategies pursued by the businesses and provides capital for use by the business units. Good communication and well-established and defined roles are needed to ensure optimal business performance.

One of the criticisms of corporate parents is that the corporate parent loses touch with the business units. The business units of multi-business organisations create value through direct contact with customers. Many theorists and business practitioners feel that it is at the business level where real competitive advantage is developed, and the

corporate parent is not in touch with the events and circumstances at that level. Some corporate parents adopt a hands-off approach for the reason that acquired companies are well run and in the best position to add value. Even so, the corporate parent has supervisory and some advisory responsibilities. Between the two polar opposites, many corporate parents opt for varying mixes of involvement and detachment, even in the same organisation. Arguably, control may be tighter over struggling business units than with stronger-performing ones. The key is to harmonise business units' strengths with the parent's resources and capabilities. This harmony contributes to the creation of unique advantages for the multi-business organisation.

Parenting advantage refers to the synergy and benefits created in a multi-business organisation where more value is created for an organisation because of the parent. This essentially means that the business is more successful than its competitors because of the corporate parent. It is recognised that the biggest challenge facing multi-business organisations is to perform better in aggregate under the parent's ownership than they would if they were independent entities, and that the parent creates sufficient value to more than offset its cost. The corporate parent should aim to be the best possible parent for its businesses. The businesses under its stewardship should perform better than they would as stand-alone entities, but also better than they would under the stewardship of any other parent. Parenting advantage should guide decisions about the nature of the businesses in the portfolio, and about the structure of the parent, and its activities and relationships. Competitive advantage has become the touchstone for successful business strategies, guiding strategic analysis and providing a basis for assessing alternative action plans.

The corporate parent's decision to intervene or not depends on the parent's understanding of business units (children) and its ability to help.⁷⁷ This is amply demonstrated by the parenting matrix or Ashridge portfolio display, depicted in [Figure 10.3](#).

[Figure 10.3](#) illustrates that a corporate parent that clearly understands the dynamics and markets of its business units has a greater chance of adding value than one without such knowledge. [Figure 10.3](#) may be interpreted as follows:

- With ballast businesses, the parent understands the business unit's business but is in a poor position to help. In this case, business units should be left to operate with minimal supervision.
- By contrast, alien businesses combine a poor understanding of business units and a limited capacity for parental help. Clearly, the corporate parent should steer clear of these.
- Value trap businesses are dangerous. They appear attractive because there are opportunities for the corporate parent to add value, but there is a high level of danger that the parent's attentions will result in more harm than good. Value trap businesses should only be included in the future strategy if they can be moved into the heartland.⁷⁸
- The ideal scenario is that of heartland businesses where the parent understands the business units and is in a solid position to advance their cause. A South African example of a heartland business is the Naspers Group. Naspers is a broad-based e-media company that operates in multiple markets. The group's principal operations are in internet platforms (focusing on commerce, communities, content, communication and games), pay television and the provision of related technologies, and print media, including the publishing, distribution and printing of magazines, newspapers and books. Most of Naspers's businesses hold leading market positions.⁷⁹

Figure 10.3 The parenting matrix⁸⁰

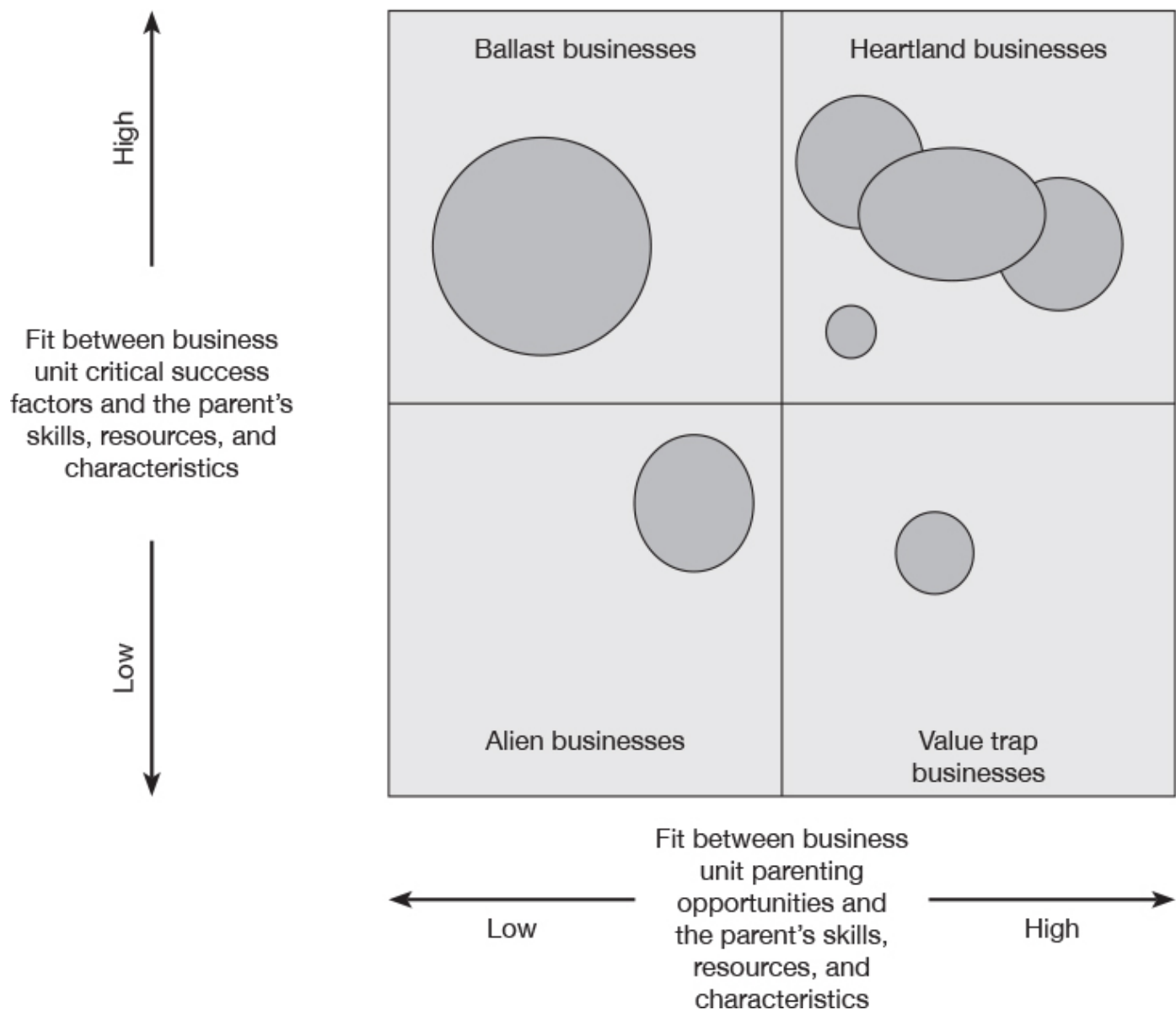


Figure 10.3 illustrates the strategic implications for corporate parents. In particular, if the parent neither understands a business unit nor is in a position to help out, it should step aside. It is also wasteful to retain experts to oversee business units that require little help.⁸¹ Increasingly, organisations are removing management levels to hasten the decision-making processes to gain first- or early-mover advantage. While judicious intervention can yield dividends, care must be taken not to overwhelm business units. Assistance must be selectively applied rather than in blanket fashion. Competitive advantage may well hinge on defining the appropriate role of corporate parenting in a diversified organisation. Often enough, value is best delivered independently by strategic business units.

10.6.2 Managing the corporate portfolio

A portfolio refers to the mix of businesses in a corporate entity. As discussed in this chapter, many organisations operate businesses in different industries. Portfolio strategies are used to guide corporate policy. Two-dimensional matrices in particular, represented by a table of rows and columns, provide a snapshot view of an organisation's investments. Action is then tailored to the circumstances facing each business unit. Optimistic scenarios call for a different set of strategies than those required for companies facing decline and decay, for example. A matrix is a

framework, tool or map used in strategic decision-making. Matrices can be useful to structure strategic information to enable better decision-making, or to evaluate past decisions.

Critics, however, regard matrices as simplistic, blunt instruments. For example, two-dimensional matrices obscure the complexity of underlying variables. In other words, strategic choice depends on an intricate set of variables whose association is far from obvious. Selecting two variables as decision criteria may therefore be misleading.

As mentioned, the portfolio's size and makeup changes over time. But on what basis? For all their faults, matrices continue to underpin portfolio management. This is largely attributed to their intuitive appeal. The following section considers the Boston Consulting Group matrix used in managing a portfolio of businesses. In practice, there are many more. [Chapter 9](#) discussed the SWOT matrix – it also finds useful application in multi-business organisations.

10.6.2.1 The original BCG framework

The Boston Consulting Group designed the BCG matrix in the early 1970s. This matrix considers market share and market growth, and is built on a number of premises:

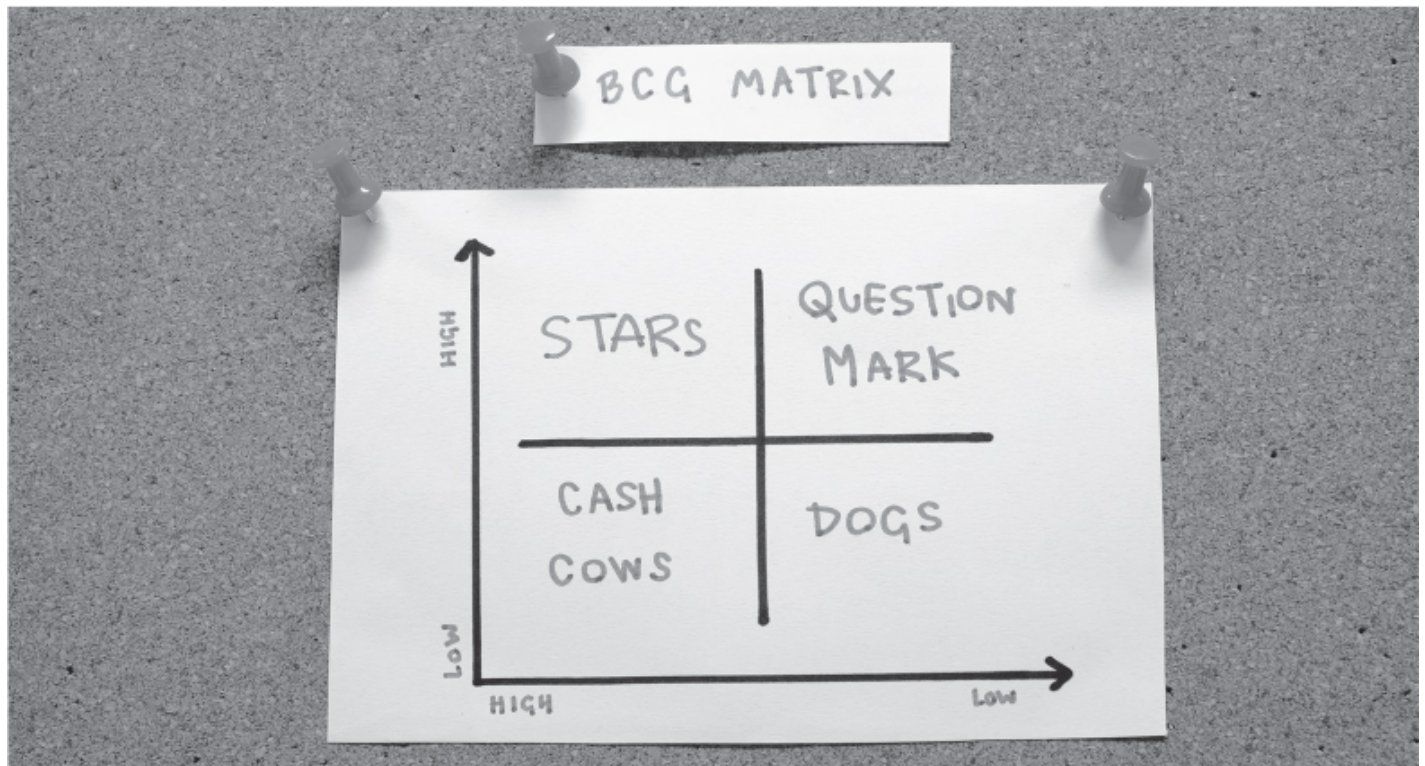
- First, the margins earned by a product and the cash generated by it are a function of market share.
- Second, sales and revenue growth require investment.
- Third, no business can grow indefinitely. As such, a product will at times be less profitable because the amount of money being spent to develop it exceeds its earning potential.

The BCG matrix consists of four quadrants that enable the strategic decision-makers to plot the organisation's products or business units in terms of market share and market growth rate:⁸²

- Q1 is the most promising, with subsidiaries (or products) labelled as stars.
- Q2 contains the question marks (or problem children) so-called because of their low market share. Depending on how they are nurtured and on the surrounding environment, they may turn into either stars or dogs.
- Q3 refers to subsidiaries or products labelled as dogs – they have little to recommend them.
- Q4 represents cash cows – subsidiaries or products that are ripe for harvesting to feed stars and deserving problem children.

The Boston Consulting Group refined the original BCG matrix and developed the BCG environments matrix⁸³ that proposed that there are four different types of industry based on the potential size of the competitive advantage available to leaders and how many ways there are to create advantage.

Figure 10.4 The BCG matrix



As mentioned above, the use of matrices is often criticised. Specifically in the case of the BCG matrix, profitability is ignored as a criterion when the matrix recommends divestiture of the dogs on the basis of their low market share and low growth. For instance, Rolls Royce may well qualify as a dog in this analysis, but it remains profitable and need not be discarded. Other products rejected by portfolio analysis can be turned around by experienced managers. Besides, growth in market share can be spurred by lower prices and unprofitable sales.

Matrices also ignore potential volatility in markets. For example, there was rapid growth in the Croc shoes range, but this was followed by a sharp decline in demand. Today's star may transmute into tomorrow's dog, thus perpetuating a transient fashion on the strength of a single assessment could prove costly. In an attempt to stimulate more market growth, Crocs introduced additional ranges that prolonged their status as stars.

10.7 Summary

This chapter described the corporate level strategy options. An organisation's strategic decision-makers need to choose a specific strategy, or combination of strategies, to achieve its overall strategic intent and strategic objectives. Although the grand or corporate strategies are more applicable to organisations that have a variety of business units, they are, however, also applicable to those with single lines of business.

The strategic decision-makers of multi-business organisations need to make decisions on the number and type of industries and businesses they want to compete in. These decisions are made at the corporate level and are an ongoing process rather than an event. Corporate level strategies deal with questions such as whether or not the organisation should focus on just a few products and markets, or whether it should have a much broader focus in terms of its scope by offering diversified products or services and/or serving diversified markets.

The selection of a corporate strategy, or combination of strategies, forms part of the strategic planning or formulation stage. Again, the choice of strategy is influenced by all the factors identified during the environmental analysis stages as well as the overall strategic direction of the organisation. Referring to the strategic management

framework introduced in [Chapter 1](#), the stakeholders and their claims would also be considered in the selection of the strategy.

For corporate strategy, organisations can choose either to grow or defend their businesses. To recap, growth can occur internally in the form of organic growth, namely market penetration or consolidation. Other growth options include market development, product development and innovation. Externally, the organisation can diversify into related or unrelated fields, or it can integrate vertically or horizontally. There are various corporate strategic actions that can be employed to achieve the corporate goals. Organisations can also use a range of cooperation strategies to achieve their goals, such as joint ventures and strategic alliances. With defend strategies, the strategic decision-makers must choose between turnaround or managing the end game.

This chapter also discussed the role of the corporate parent, whose decisions and actions affect all the business units that comprise the multi-business organisation. There are different levels of involvement, and it is important to be aware of and understand the role of the corporate parent. Finally, the chapter discussed the use of the Boston Consulting Group matrix for managing the portfolio. It was confirmed that matrices have some value, but their use is often criticised due to their static nature.

Strategic choice is therefore fundamental to survival or prosperity. As the chapter clearly spelt out, for example, attempting growth during troubled times is a recipe for failure. By contrast, when opportunities match strengths, the temptation to expand should not be missed. Either way, organisations must continually fine-tune themselves in line with the evolving environment.

REFLECTION BOX:

Mergers and acquisitions often end up destroying business value and are often associated with high failure rates and high risks. Why do you think this is? Do you believe mergers and acquisitions can add business value if they are executed correctly? If so, what are the criteria for successful mergers and acquisitions?

Opening case study questions

1. Gather more information on Super Group and identify the corporate strategies that it is pursuing.
2. Comment on the appropriateness of corporate strategies in terms of Super Group's growth objectives.
3. Explain the criteria Super Group should consider to identify an appropriate strategic alliance partner.
4. Discuss the role of the Super Group corporate parent in creating synergy and parenting advantage.

Discussion questions

1. Explain how corporate strategy differs from business strategy.
2. Use the annual report of an organisation of your choice to identify the corporate strategies that the organisation has chosen.
3. Under which conditions should organisations undertake the following strategies:
 - Vertical integration
 - Liquidation?
4. Describe the potential dangers of unrelated diversification.
5. Explain how the BCG matrix can assist with strategic choice.
6. Comment on the role of the corporate parent.

Using knowledge and skills

1. Consider the corporate portfolio of a multi-business organisation that you are familiar with. Visit its website to read about its business and the integrated reports. Identify the corporate strategies pursued in the last five years. Has this organisation reconsidered its strategies and opted for defensive strategies in the last year? Why do you think it was necessary to reconsider their strategic choices?
2. If you had to design a corporate strategy for your preferred banking institution, what factors would you consider and what strategies would you recommend?
3. If you were required to advise on corporate strategies for the South African retail industry, what factors would you consider? Use the BCG matrix to position the industry players and make recommendations.

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Suggested websites

- Africa Academy of Management (<https://www.africaacademyofmanagement.org/>) – A global organization for academics and practitioners interested in advancing management education and research in Africa
- The Boston Consulting Group (<http://www.bcg.com>) – A global management consulting firm and the world's leading advisor on business strategy that partners with clients in all sectors and regions to identify their highest-

value opportunities, address their most critical challenges, and transform their businesses

The Australian and New Zealand Academy of Management (<https://www.anzam.org/>) – A professional body for management educators, researchers and practitioners

Corporate Executive Board (<http://www.corporatestrategyboard.com>) – This enables superior business outcomes by delivering authoritative data and tools, best practice research and peer insight to the leaders of the world's great enterprises

Strategic Management Society (<http://www.strategicmanagement.net>) – Membership, composed of academics, business practitioners, and consultants, focuses on the development and dissemination of insights on the strategic management process, as well as on fostering contacts and interchange around the world

Harvard Business Review (<http://hbr.harvardbusiness.org/>) – Journal of the Harvard Business School

Easy-Strategy.com (<http://www.easy-strategy.com>) – Osama El-Kadi: Sun Tzu *Art of war* strategist and motivational speaker for business

McKinsey Quarterly (<http://www.mckinseyquarterly.com/home.aspx>) – The business journal of McKinsey & Company, a global management consulting firm used by the world's leading businesses, governments and institutions

Bain & Company (<http://www.bain.com/consulting-services/strategy/corporate-strategy.aspx>) – This website shares valuable resources on corporate strategies from one of the leading management consultancies

Institute of Management Consultants and Master Coaches of South Africa (<http://www.imcsa.org.za/>) – Publications and certifying body of management consultants

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CHAPTER 11

Strategies for international competitive advantage

Ernst Neuland

LEARNING OUTCOMES

After reading this chapter, you should be able to:

- define globalisation and identify the drivers of globalisation
- explain why and how organisations internationalise
- evaluate the meaning of international competitive advantage
- discuss the international strategies that organisations can pursue
- explain under what circumstances the different international strategies are appropriate
- identify and compare the various modes of foreign market entry
- explain the steps in an integrated international strategic management process.

KEY TERMS

country-specific advantages (CSAs)

culture

economic systems

firm-specific advantage (FSA)

foreign direct investment (FDI)

foreign market entry modes

foreign portfolio investment (FPI)

geopolitical forces and events

global companies

global strategy

globalisation

globalisation of markets

globalisation of production

international business

international competitive advantage

international enterprise

international management

international strategic management process

international strategy

international trade

legal systems
liability of foreignness
macro political risk analysis
micro political risk analysis
multidomestic or localisation strategy
multinational enterprise (MNE)
national competitive advantage
political system
regional economic integration (REI)
strategic orientation
transnational strategy

OPENING CASE STUDY



Standard bank to expand footprint in francophone Africa¹

Standard Bank, South Africa's largest bank, announced in April 2018 that it had opened a fully licensed bank in Abidjan, Côte d'Ivoire, to focus on the needs of corporate and investment banking clients and thereby cementing its presence in the Francophone West African region. Until now, the Standard Bank Group only had a presence in Anglophone West African countries such as Nigeria and Ghana.

The Standard Bank Group, now present in 20 African markets, will operate as Stanbic Bank Côte d'Ivoire, and will serve multinational enterprises, many of which the bank says have existing relationships with the group. The group's Africa business tripled to more than R26 billion in 2017, up from R10 billion in 2010. Standard Bank says it began scoping the market of Côte d'Ivoire as far back as 2013, opening a representative office with a small core team in 2014. The bank was awarded its banking licence in 2016. Given Côte d'Ivoire's current annual GDP growth rate of around 8% and GDP per capita in terms of purchasing power parity of \$3 900 appears to have vindicated Standard Bank's decision to expand operations to Côte d'Ivoire. Commenting on the launch in April 2018, Stanbic Bank's CEO for Côte d'Ivoire, Herve Boyer, said: 'We look forward to partnering with our clients in Côte d'Ivoire. Côte d'Ivoire with its vibrant financial services sector and competitive banking industry is an excellent launch pad for Standard Bank to expand its services and we look forward to being able to contribute to the economic development of the country.'

'Our strategy is focused on sectors driving Africa's growth through proactive client partnerships that deliver relevant solutions. We continue to utilise our presence in, and deep knowledge of the Africa markets to support our clients' growth aspirations across the continent and link them to global trade corridors and key financial centres,' Kenny Filha, Standard Bank's chief executive for corporate and investment banking said. The West Africa Economic and Monetary Union (WAEMU), of which Côte d'Ivoire is a member, also offers Standard Bank substantial business advantages stemming from its stable single currency pegged to the euro, and a shared central bank and stock exchange, as well as its harmonised business legal structures. The country is ideally positioned as a hub for the region, which also includes Benin, Burkino Faso, Guinea-Bissau, Mali, Niger, Senegal and Togo. Sola David-Botha, Standard Bank's chief executive for Africa regions, said of the opening: 'Having an operational presence in Côte d'Ivoire supports Standard Bank's strategy of being Africa's leading financial services organisation and our drive to broaden and deepen our footprint on the continent. Standard Bank aims to support the growth of our clients and in so doing, drive inclusive economic growth across the region. Ultimately, that will support sustainable job-creating growth and wealth creation, and deepen integration of African markets into the global economy.'

The bank has said its operations elsewhere in Africa, including in oil-rich Angola and Nigeria, delivered a robust performance while its home market suffered as a weak economy hit by both consumption and investment spending. However, having just established itself in Côte d'Ivoire, Standard Bank was already casting its eyes to Senegal, seeking a banking licence in that country to entrench its footprint in Francophone West Africa. Senegal was seen as Standard Bank's next destination for growth.

Overview

This chapter examines the motives for internationalisation and the strategic options available to organisations intent on expanding their operations to foreign markets. The chapter first looks at the phenomenon of globalisation as the context for international business, briefly considers the dynamic global business environments that international organisations face, and identifies the more important sources of international competitive advantage. The chapter then discusses the relevant international competitive strategies and foreign market entry modes that organisations pursue in their quest for international competitive advantage, and concludes with an integrated strategic management framework for organisations that compete internationally.

11.1 Introduction

International business occurs through trade and direct investment across national borders, and hence differs profoundly from purely domestic business that is confined to doing business within a specific country.² Based on the fundamental concepts of strategy and strategic management discussed in earlier chapters, this chapter now extends strategic thinking and strategising to the global business arena. However, for any degree of success in international business, international managers need a fundamental understanding of globalisation and its implications for international business, why and how international expansion takes place, the extent to which global business environments typically differ from domestic ones, and how **international competitive advantage** is derived. International managers should furthermore know how to identify foreign markets, which international strategies to pursue in specific circumstances, how to enter foreign markets, and how to reconfigure a firm's **organisational architecture** to effectively support its international strategies. Ideally, a multinational enterprise (MNE) should integrate all these initiatives in an integrated international strategic management process, as outlined in [section 11.8](#). For example, it is clear that Standard Bank's decision to enter the Côte d'Ivoire market profiled in the opening case highlights some of the unique issues and challenges of international expansion that we will explore further.

The main aim of this chapter, therefore, is to provide an integrated international strategic management framework for multinational enterprises intent on expanding internationally. After defining selected concepts uniquely related to international business, an overview of globalisation as the context for international business is provided.

11.2 Concepts in international business

Strategic management forms a unique approach to innovative organisational management. Although some concepts related to international business were already introduced in [Chapter 5](#), we need to define the more important concepts related to the dynamics, strategies, structures and environments of international business.

We introduced **international business** as comprising of international trade and foreign direct investment (FDI). **International trade** occurs when a firm exports goods or services to consumers in another country. Whereas **foreign direct investment** involves direct investments in a foreign country for productive business purposes, the related concept of **foreign portfolio investment (FPI)** refers to investments in negotiable financial instruments –

shares, stocks, bonds, options and futures – in off-shore financial markets. While an **international enterprise** could be involved in any international business activity, such as importing from and exporting to other countries, sourcing from or outsourcing to other countries, or involvement in a strategic alliance with a foreign partner, a **multinational enterprise (MNE)** involves ownership and control of productive cross-border business operations through FDI. (Multinational enterprises are also referred to as multinational corporations, multinational companies or MNCs.) **Global companies** in turn are MNCs characterised by extensive global networks of operations. (Global companies are at times also referred to as transnational or globally integrated companies.) **International management** is the process of applying management concepts and techniques in a multinational environment and adapting management practices to different political, legal, economic and cultural contexts. The concept of ‘international strategy’ can be viewed generically (meaning any strategy involving international business), but it also has a specific meaning as one of the following four competitive international strategies available for international involvement:

- **International strategy**: a strategy to increase profitability by transferring core competencies to foreign markets where indigenous competitors lack those competencies
- **Multidomestic** or **localisation strategy**: a strategy to increase profitability by customising products and services to comply with the tastes and preferences of customers in distinct foreign markets
- **Global strategy**: a strategy involving global standardisation to increase profitability through cost reductions from experience curve economies derived from decreasing costs over time as experience is gained and from location economies, derived from operations in low-cost foreign locations
- **Transnational strategy**: a strategy pursued by globally networked companies to increase profitability by exploiting experience-based cost and location economies while simultaneously complying with local responsiveness in foreign markets.

However, while the concepts ‘international’, ‘multidomestic’, ‘global’ and ‘transnational’ have specific meanings when referred to as strategies, they could also refer to industries, organisations, products and services, depending on the specific context in which these terms are used.³ The four international strategies, and their characteristics and implications for international, multinational and global business enterprises are discussed in [section 11.7](#). In the section that follows we focus on the concept of globalisation and its implications for international business.

11.3 Globalisation: The context of international business

Although we briefly referred to the global business environment in [Chapter 5](#) ([sections 5.2](#) and [5.4.8](#)), and broadly defined **globalisation** as the shift away from distinctive national markets towards a more integrated and interdependent world economy,⁴ it is an elusive concept to define, and means different things to different people. We therefore need to consider that globalisation could be defined from diverse perspectives.

From an economic perspective, globalisation is a process primarily associated with increasing economic openness, growing interdependence among countries and regions, and ongoing integration of the global economy. This is, *inter alia*, reflected in the increasing cross-border flow of goods, services, capital, information and knowhow, as well as by the rapidly increasing number of MNEs worldwide in recent years. We thus refer to globalisation as a shift in the world economy away from national economies and distinct national markets to a largely interdependent and interlinked global economic system.⁵ However, the economic definition of globalisation could also be expanded by giving it a political, social, cultural and geographic dimension.⁶

The scope of one’s focus when defining globalisation could also influence the definition – do we consider globalisation from the perspective of the entire world, a single country, a specific industry, an individual organisation, or even a particular line of business? At the worldwide level, as already stated, globalisation refers to

the growing economic interdependence involving increased cross-border trade and investment, information and technology transfer, and global business networking.

According to Segal-Horn,⁷ a starting point for understanding the phenomenon of globalisation from a strategy perspective is realising that it is firms within industries that globalise by expanding internationally, and not countries. An industry can be defined as global 'if there is some competitive advantage in integrating industry activities on a worldwide basis,'⁸ while a market is defined as global 'if consumers worldwide can be treated as homogeneous within such markets.'⁹ However, it is much more common for market segments to be global than entire markets.

Since firms will obviously compete in the same industry or industries overseas as at home, globalisation at the level of a specific organisation in a specific industry refers to the extent to which the organisation's competitive position in its industry at home is interdependent on that of the same industry in another country. Global companies are therefore companies that compete in the main markets of the world in an integrated and coordinated way, as in the case of Coca-Cola, IBM, Sony, Philips, Nokia, Intel, Canon and Anheuser-Busch InBev (the new name of the Anheuser-Busch InBev and SABMiller merger announced in November 2017). Not surprisingly, organisations in the same industry invariably confront each other as competitors in one nation after another.¹⁰

The virtues of globalisation have been the topic of (often heated) debate in recent times, involving arguments in support of globalisation and its perceived benefits on the one hand, and serious concerns regarding its adverse implications on the other. Arguments supporting globalisation include promoting free trade, which enhances socio-economic development, provides greater consumer choice, and creates more and better jobs. Concerns include its threat to national sovereignty, producing uneven results across nations and people, adversely affecting labour and labour standards in many countries, and contributing to a decline in environmental and health standards across countries, more often in developing countries.¹¹

In the sections that follow we discuss two strategically important facets of globalisation in international business – the globalisation of markets and the globalisation of production – and identify the strategically important forces that drive globalisation as opposed to those that drive localisation.

11.3.1 The globalisation of markets and production

Two sets of opposing forces – those of globalisation and localisation – are continuing to shape the competitive structures of industries and markets across the world. Globalisation forces induce international organisations to align their international business systems and strategies along global lines, which requires them to compete on cost and price by offering standardised products on a worldwide basis. In contrast, localisation forces require international organisations to customise and adapt their products for each foreign market for reasons that include, *inter alia*, cultural differences and host country demands. As explained in [sections 11.7.3 and 11.7.4](#), unlike globalisation forces, localisation forces compel organisations to view each national foreign country market as a distinctly separate market.¹²

11.3.1.1 Globalisation of markets

In the early 1980s, Theodore Levitt visualised the [globalisation of markets](#) as the merging of traditionally separate national markets into one huge global marketplace over time as a result of converging national value systems, consumer needs and preferences on a worldwide scale.¹³ This trend has been occurring in product categories such as consumer goods, industrial products, electronic products and many business services, which has resulted in benefits for MNEs such as economies of scale and reduced marketing costs as well as new market opportunities, especially in the digital e-business domain.¹⁴ However, significant differences in consumer needs and preferences for many products and services still exist worldwide, mainly as a result of embedded differences between national

cultures and their value systems. As will be shown in [sections 11.7.2 and 11.7.3](#), these inherently conflicting forces of globalisation and localisation are decisive in an international organisation's choice of strategy for specific foreign markets.

11.3.1.2 Globalisation of production

The [globalisation of production](#) has mainly been facilitated by declining barriers to trade and investment in recent decades, allowing international organisations to benefit from:

- lower costs and/or improved quality: by sourcing goods including raw materials, products for assembly, and services from low-cost countries; and
- location economies: dispersing production facilities or certain value chain activities to optimal cost-effective foreign locations around the world through off-shoring, or outsourcing specific activities to such low-cost locations. Nike is a good example in this regard. While Nike's headquarters is in the US, it has no manufacturing facilities there, and these operations have all been located in countries with low labour and production costs, mainly in Southeast Asia.

As with the globalisation of markets, substantial impediments to the globalisation of production still exist. For example, formal and informal barriers to trade and investment between countries, high levels of economic and political risk, unfavourable exchange controls as well as government interference continue to impede the internationalisation activities of organisations in many countries. However, notwithstanding these constraints, the growing number of MNEs in recent years and their continuing expansion to foreign locations have undoubtedly contributed to the ongoing process of globalisation.¹⁵ Against this background of the globalisation of markets and production, we briefly consider its main drivers.

11.3.2 Drivers of globalisation

Identifying the drivers of globalisation with a view to assessing their implications for MNEs in increasingly competitive global business environments has become imperative for any degree of success. We accordingly explore the following two main drivers as well as other drivers of globalisation:

- The ongoing phasing out of barriers to international trade and investment
- Unprecedented advances in communications and transportation technologies

11.3.2.1 Declining barriers to trade and investment

Governments have traditionally imposed tariff and non-tariff barriers on imports for reasons that include the protection of domestic industries and the generation of income. The General Agreement on Tariffs and Trade (GATT), established in 1948, and the World Trade Organization (WTO), its successor since 1995, have been instrumental in the successful promotion of free trade in goods. Likewise, the General Agreement on Trade in Services (GATS) has served to promote free trade in services, and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) has enhanced equity in international property rights, while the WTO has also greatly enhanced FDI worldwide in recent decades.¹⁶ Declining barriers to trade, and the gradual phasing out of tariff and non-tariff barriers imposed by governments on imports have undoubtedly encouraged a freer flow of goods and services internationally, thereby enhancing world trade and also globalisation. Average tariff rates decreased markedly from more than 20% in 1950 to around 4% by 2010 for most developed countries.¹⁷ The main purpose of the WTO therefore is to help the free flow of trade and investment, to review trade policies, to administer trade agreements, and to settle trade disputes among its members.¹⁸

International trade grew significantly since the 1950s due, *inter alia*, to the gradual decline in barriers to trade. By 2012, the volume of world trade was 31 times larger than in 1950, while the world economy was 8.7 times larger (in

real terms, adjusted for inflation), most decidedly a driver of globalisation. Worldwide, the stock of outward FDI increased by a factor of 13 between 1998 and 2014.¹⁹

Likewise, increasing **regional economic integration (REI)**, which refers to the growing economic interdependence that results when two or more countries within a geographic region form an alliance aimed at reducing or eliminating barriers to trade and investment, has also contributed to expanding international trade and investment through the formation of trade blocs and free trade areas among groups of countries. This has largely resulted in the elimination of barriers to trade and investment between member countries as in the case of the North American Free Trade Agreement (NAFTA) between the US, Canada and Mexico, and the 28-member European Union (EU). Bilateral and multilateral agreements and treaties such as the bilateral agreement between the Southern African Development Community (SADC) and the EU will undoubtedly benefit countries in the SADC region, including South Africa, as is evident from the Case example *The European Union and South Africa*.

CASE EXAMPLE: The European Union and South Africa²⁰

The EU and South Africa concluded a Trade, Development and Cooperation Agreement (TDCA) which came into effect on 1 January, 2000, according to which 95% of South African exports to the EU were duty free, as were 86% of all EU exports to South Africa. Since 2000, the TDCA has provided significant opportunities for South African organisations doing business with the EU. However, the TDCA 'Trade Chapter' was to be replaced by the SADC–EU Economic Partnership Agreement (EPA), which was signed by both parties on 10 June 2016 and provisionally became operational on 10 October 2016. Both the TDCA and EPA packages contain agricultural products to be exported by South Africa into the EU market under the so-called Transformation Regime Quota (TRQ). For example, South Africa stands to benefit from the improved market access on wine, sugar and ethanol, among others, whereas some of the EU's meat products will enter the SADC under new TRQs.

11.3.2.2 Advances in technology

Increasing advances in information and communications technology (ICT), as well as in transportation and related technologies over the last four to five decades have also enhanced the trend toward greater globalisation. Low-cost, rapid computing and data processing have revolutionised worldwide telecommunications, information flows, financial activities and transactions, as well as global logistics and sourcing. Exponential growth of the internet, the World Wide Web and social media has vastly increased the scope, speed and reach of international businesses. While an estimated 1.6 billion users were connected to the internet in 2009, this number grew to over 3.8 billion by June 2017, reflecting a global internet penetration rate of 51.7%, which is still growing.²¹

Furthermore, the traditional constraints of geographic distance and location, scale of activity and time zones have largely been eliminated due to increasing e-commerce and digital networks. It has been estimated that over half of all retail e-commerce worldwide in 2018 would have been done in China, a pacesetter in mobile shopping.²²

As far as telecoms are concerned, many companies including SK Telecom, China Mobile and T-Mobile were preparing for the arrival of the vastly improved 5G technology by 2018.²³

Ongoing developments in transportation such as large-scale commercial jet aircraft, technologically advanced freight ships, containerisation, and highly effective airport and harbour infrastructures have likewise aided the globalisation process with regard to speed, capacity, efficiency, increased load factors and rapid turnaround times, enabling, *inter alia*, the rapid and efficient worldwide transportation of perishable products. However, the emergence of electric vehicles, self-driving cars and trucks, air taxis and an astounding array of drones is bound to irrevocably change the characteristics of mobility in both the global business landscape as well as in communities. A number of such innovative, and at times dramatic, technological trends, developments and products with profound implications for international business and ongoing globalisation were discussed in [Chapter 5 \(section 5.3\)](#)

11.3.2.3 Other drivers promoting globalisation

Apart from the two main drivers of globalisation discussed in the previous section, others within and across industries and countries include the following:²⁴

- *Multinational enterprises*: MNEs have contributed significantly to globalisation through their increasing numbers and continued establishment of subsidiaries in foreign countries, as in the case of Toyota's subsidiaries in South Africa and in other countries, Anheuser-Bush InBev's global network of brewing operations, and the four major South African banks into Africa (see the Opening case *Standard Bank to expand footprint in Francophone Africa*).
- *Global competition, cost-reduction pressures, and economies of scale and scope*: Organisations in capital-intensive industries such as in steel and motor vehicles are increasingly forced to export part of their production output to attain economies of scale, tending to accelerate globalisation of the industries concerned (see [section 11.9.1](#), Strategy in action *Mahindra plans assembly in South Africa*).
- *Escalating costs of research and development (R&D)*: The need to recover rising costs of R&D in certain industries such as commercial aircraft production and in the pharmaceutical industry compels organisations in these industries to sell their products globally.
- *Cultural homogenisation*: As highlighted in [section 11.3.1.1](#), traditionally different cultures are gradually becoming more alike due to, *inter alia*, increased international travel, global communication, entertainment and advertising. Cultural homogenisation therefore has the potential for the gradual convergence of markets and consumer needs.
- *Industrialisation, economic development and modernisation*: Industrialisation implies that economies in emerging market regions such as those in Asia, Latin America and Eastern Europe are moving from being low-value-adding commodity producers to relatively sophisticated, competitive producers and exporters of high-quality products such as software (India), motor vehicles (Czech Republic) and aircraft (Brazil). These developments have facilitated the spread of ideas, products and services across the globe.
- *Integration of world financial markets*: The integration of world financial markets has made it possible for internationally active organisations to obtain capital from international financial markets, invest in foreign markets, and engage in foreign exchange transactions. Globalisation of finance has greatly enhanced world-scale production and marketing operations.
- *Government and industrial policies*: Government policies can accelerate or impede the trend towards globalisation. Within WTO guidelines, government encouragement in the form of subsidies and preferential tax treatment in selected industries such as steel, motor vehicles, semiconductors, telecommunications, chemicals and agriculture to stimulate both inward FDI and exporting also provide further stimulus for globalisation. South Africa's current Automotive Production and Development Programme (APDP) has been a major and extremely successful export incentive for the country's vehicle manufacturing industry.²⁵

11.3.3 Summary

Globalisation, the globalisation of markets and production, and the drivers of globalisation discussed in this section provide a useful frame of reference for MNEs having to decide on their international strategies. International managers therefore need to consider relevant trends in or elements of globalisation, for example such as offshoring production facilities to low factor cost countries to capitalise on location economies. However, such trends or elements will have different effects in different circumstances, depending, *inter alia*, on the company, its line of business and the countries in which it is involved. In the section that follows we establish why international business is different, why business organisations expand internationally, and how they do it.

11.4 The global business imperative

In a world of globalisation, freer trade and investment, rapidly changing technologies, and the emergence of new competitors from newly developing markets, organisations in almost all industries are compelled to consider international expansion.²⁶ Managers therefore need to understand how international business differs from domestic business, why they would consider international expansion and, once decided to internationalise, how they should do so. The discussions that follow will relate primarily to MNEs as the main actors in the global business arena, notwithstanding the continued importance of small- and medium-sized enterprises (SMEs) in this regard.

11.4.1 Why international business is different

As we know, international business implies trading with and/or investing in other countries. According to Collis,²⁷ a firm that considers expanding internationally needs to have a superior domestic competitive advantage at the outset, referred to as its **firm-specific advantage (FSA)**. This refers to a distinctive bundle of resources resulting in a superior domestic competitive advantage that allows the firm to consider international expansion. This superior competitive advantage is then exploited internationally, with the potential of benefiting from country factors in the foreign countries concerned, where these benefits could, for example, result from lower tax rates, lower financing costs and more inexpensive labour than in the organisation's home country. These are referred to as **country-specific advantages (CSAs)**. Thus, given an MNE's involvement in different countries, managers have long since realised that international business differs significantly from purely domestic business, and managing international operations is more demanding, which is patently clear from the opening case on Standard Bank. The main reasons why international business differs from purely domestic business are discussed below.

11.4.1.1 Differences between countries

Countries differ regarding their political, legal, economic and social systems, as well as their cultures, demographics, physical characteristics, levels of economic development, extent and quality of their infrastructure, and levels of technological proficiency. Differences in these country factors, especially if they are sources of country-specific advantages (CSAs), are critically important when MNEs have to devise their international strategies. The most important of these macroenvironmental factors, relating to international business operations are highlighted in [section 11.5](#). For international business, the more important country differences include those discussed in the following sections.

11.4.1.2 Complexity of international business

International business is undoubtedly much more complex than domestic business, mainly for the following reasons:

- There is the need to decide to which foreign country or countries to expand operations.
- It is necessary to decide how to operate in any number of foreign countries, all with vastly different political, legal, economic and sociocultural systems.
- It is necessary to decide on an appropriate international strategy, or strategies.
- It is necessary to decide how to enter foreign markets.
- It is important to decide how to adapt a firm's organisational architecture, including its organisational structure in terms of centralisation or decentralisation, and its business, managerial, coordination, operational, information, networking and reporting systems to support its international strategies.

The greater complexity of international business stems mainly from the above-mentioned decisions that are of no or little concern to a purely domestic organisation.

11.4.1.3 The role of international organisations and agreements

International business involvement requires a sound understanding of the international trade and investment environment, the role and functions of international organisations such as the World Trade Organization (WTO) discussed in sections 11.3.4.1 and 11.5.2.1, and the implications of international agreements on trade such as the GATT, GATS and TRIPS. An important challenge for international management is to operate effectively within these global regulatory frameworks.

11.4.1.4 Government restrictions and intervention

A knowledge and understanding of any restrictions such as tariff and non-tariff barriers, quotas on imports into foreign countries, investment restrictions, foreign exchange controls imposed by foreign governments, local ownership requirements and ease or otherwise of establishing a business are of vital importance to international management, but again of no direct concern to a domestic organisation.

11.4.1.5 Exchange of foreign currencies and foreign exchange risk

Cross-border transactions require that money be converted from one currency into another. Foreign exchange rates are often extremely volatile and unpredictable, and have high inherent risk that, if possible, has to be effectively managed by using various mechanisms such as forward contracts and currency swaps to hedge foreign exchange risk.

While other factors could also account for differences between international and domestic operations, those mentioned here are by far the most important. We now turn to the reasons or motives for internationalisation, and why organisations would consider international expansion at all.

11.4.2 Motives for international business involvement

As previously stated, a company that has a superior domestic competitive advantage and superior resources and capabilities can consider international involvement by:

- exploiting export opportunities; or
- enhancing its scope and profitability by investment in one or more foreign countries to benefit from CSAs in those foreign markets.²⁸

However, despite the above rationale, organisations evidently also consider internationalisation for motives that could be either reactive or proactive,²⁹ as explained below.

11.4.2.1 Reactive reasons

Typical reactive reasons for internationalisation include the following:

- Saturation of domestic markets: no or, at best, limited domestic growth prospects
- Globalisation of competition: foreign competitors' intrusion into domestic markets.

11.4.2.2 Proactive reasons

The increasing trend toward international business suggests that the economic opportunities associated with operating in multiple foreign markets are significant. MNEs could capitalise on these opportunities through market seeking and/or benefiting from location economies while at the same time diversifying their risk geographically.

Proactive reasons for internationalisation are therefore closely aligned with the strategic growth imperative of organisations and new opportunities in the global marketplace. MNEs thus proactively leverage their core competencies and competitive advantage by means of:

- expansion of markets and sales through market-seeking product differentiation with the potential to realise economies of scope and scale

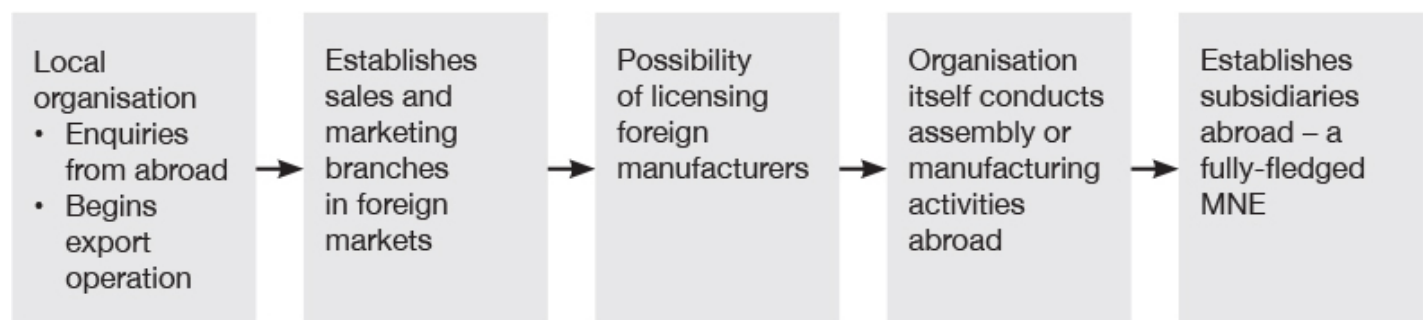
- realising location economies by moving operations to low factor-cost countries and, where required, acquiring resources internationally from such countries
- diversifying risk geographically.

To conclude, it is imperative that domestic organisations considering internationalisation also proactively revise their vision (what they seek to become over the long term), their mission (in pursuance of their vision), their objectives (both domestic and international in terms of specific targets to be achieved in pursuing their mission), and their strategies (their domestic and international action plans to achieve their objectives, including resource allocation and implementation plans) to reflect their envisaged international strategic intent.³⁰ These aspects are discussed in more detail in [sections 11.7, 11.8 and 11.9](#).

11.4.3 The process of internationalisation

Having looked at differences between domestic and international business as well as the motives for international expansion, we now turn to the internationalisation process as such. According to the classical phases theory of internationalisation, domestic organisations intent on international involvement gradually progress through a number of phases to eventually become a fully-fledged MNE, as illustrated in [Figure 11.1](#).

Figure 11.1 The typical evolution of a multinational enterprise³¹



However, not all organisations go through each of these stages, while some stop short of full integration as an MNE, depending on their specific internationalisation objectives and strategies. Although the process in [Figure 11.1](#) explains the phases through which organisations traditionally evolve to become MNEs, it does not explain what MNEs need to do to overcome the **liability of foreignness** that results from venturing into unknown territory. The liability of foreignness typically results from the following:³²

- Unfamiliarity: this involves mistakes due to lack of local country knowledge and information (including political/legal requirements, economic and cultural issues, and infrastructure)
- Relational: there are additional and often unanticipated costs of managing a foreign operation (including expatriate travel and locating costs as well as subsistence costs for the duration of the expatriate's foreign assignment), and reluctance of locals to do business with the MNE
- Discrimination: this results from the typical practice of consumers favouring local firms over foreigners.

The key requirement for MNE success therefore is that the benefits of value creation from internationalisation should exceed the disadvantages of the liability of foreignness. With reference to the opening case, the question can be asked to what extent Standard Bank faces these challenges, if at all. According to Collis,³³ at least three conditions must exist if MNEs are to create value through international expansion:

- An intrinsic competitive advantage of the firm
- An economic advantage derived from the firm's international presence

- A cost advantage to the firm by conducting the international business itself, rather than contractually through a third party.

These requirements clearly present real challenges to international management in increasingly competitive global business environments.

11.4.4 Summary

In this section we explained why international business differs from domestic business, and elaborated on both the reactive and proactive motives for internationalisation. A brief overview of the process of and requirements for successful internationalisation concluded our discussion. While [Chapter 5](#) examined the external business environment predominantly from a country perspective, we now briefly reflect on selected aspects of the global business environment facing international business organisations.

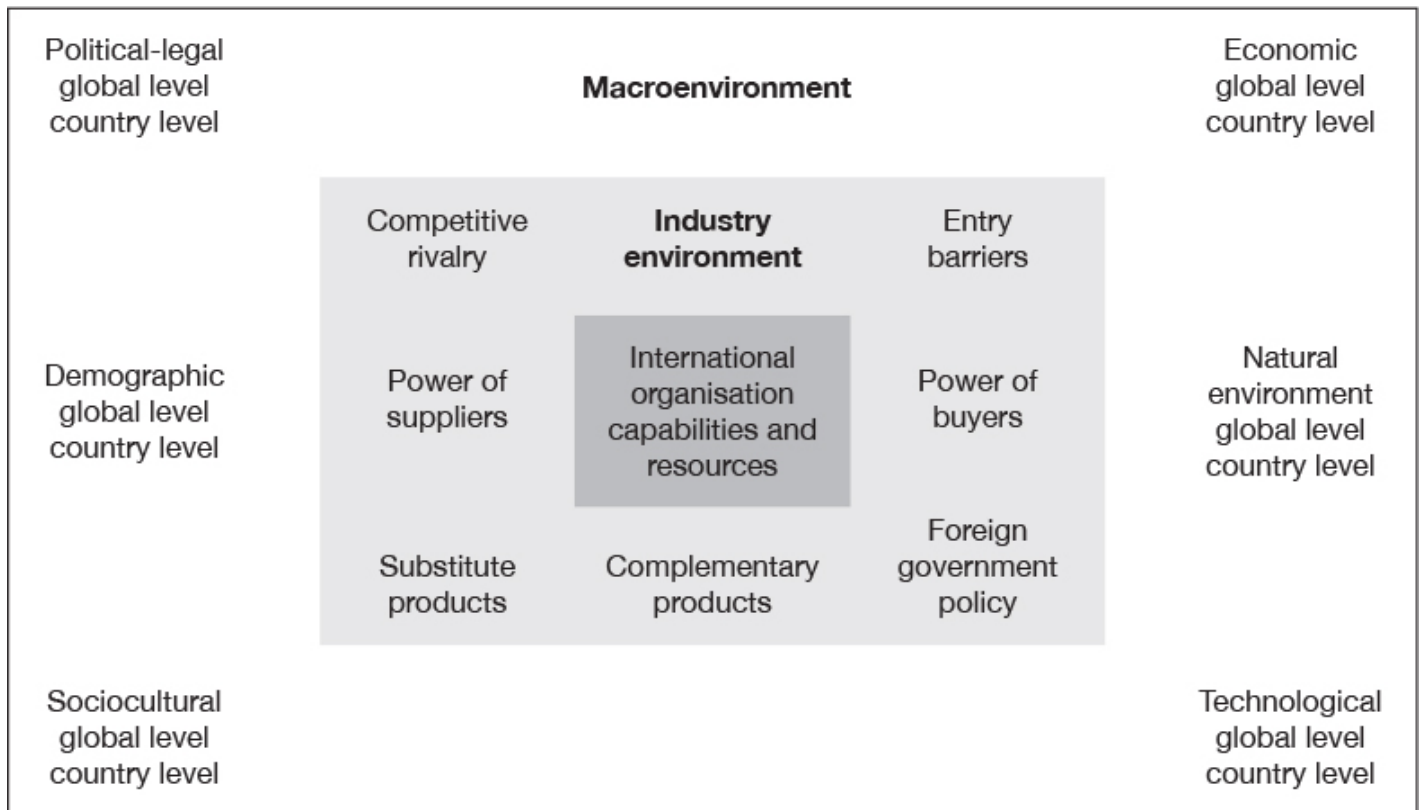
11.5 The business environment in a global context

Given the increased complexity of international business, it has long since become imperative to examine and understand the dynamic and rapidly changing macro business environments at the global, regional, country and industry levels in terms of potential opportunities and threats. In fact, Collis³⁴ emphatically states that international managers need to be acutely aware of, understand and know how to manage change in dynamic global business environments. 'If you are to develop a viable long-term international strategy, it is vital to be aware of the broad drivers of change in the global environment and the issues from those changes, however far removed from your current concerns they might appear – unless you understand the tectonic forces shaping our world, you will be oblivious to factors that determine long-term firm performance.' Since the macro business environment and industry environments in general were discussed in [Chapters 5](#) and [6](#) respectively, we merely illustrate a few selected factors and trends of specific importance to international management.

11.5.1 Importance and structure of the global business environment

Domestic organisations basically only have to deal with environmental trends and factors in their national economy, while admittedly having to remain informed of global and international trends that might be relevant to their own operations, for example the implications of a rising oil price and hence a higher fuel price on domestic transportation costs. However, MNE managements should have an intimate knowledge of the macroenvironment at the global level as well as at the country and industry levels of each of the countries in which it is involved. A brief overview of selected macroenvironmental factors at the global level is followed by looking at relevant macroenvironmental factors at the level of individual foreign countries that are arguably of more immediate importance to international management.

Figure 11.2 The international organisation and its external environments



The purpose of our discussion in this section is not to provide a detailed exposition of all possible environments and environmental factors that international managers should be aware of and analyse, but, with reference to [Figure 11.2](#), provide an illustrative framework for such analyses in any organisation's own unique circumstances.

11.5.2. Macroenvironment at the global level

The macroenvironment at the global level is characterised by pervasive trends and forces that include global political-legal institutions and forces, and economic, sociocultural, demographic, technological and natural environmental forces. At the global level, supranational institutions help to manage, regulate and police the global marketplace mainly by means of multinational agreements and treaties that govern global trade, investment and other international business-related activities. The more important role players, forces, trends and events at the global level can be broadly categorised in terms of their political-legal, economic, sociocultural and technological impacts as outlined below, while the implications of the macroenvironmental factors and forces at the level of individual countries are highlighted in [section 11.5.3](#)

11.5.2.1 Political-legal

- *Global or supranational political institutions and agreements:* The UN, through the World Bank (WB) and International Monetary Fund (IMF), aims to improve economic and social development worldwide.³⁵ As previously indicated, the main aim of the WTO is to promote free trade and investment. By July 2016, the WTO comprised of 164 member states and 29 observer states, accounting for more than 98% of total world trade.³⁶ However, despite the efforts of the WTO, by 2018 barriers to trade and investment still prevailed in many countries.
- *Geopolitical forces and events:* Continuing conflict in the Middle East, and especially in Syria at the time of writing in early 2018, have been the cause of pervasive and widespread global and regional disruptions that

seriously affect political, business and sociocultural relations. Such **geopolitical forces and events** significantly increase the risk of doing business with countries in affected regions.³⁷ Evaluation of a MNE's strategic international options should therefore include an assessment of the political risk of those countries or regions in which it is involved, or contemplate such involvement. The various types of exposure to **political risk** can be classified according to government actions or those events caused by actors outside government control, as presented in [section 11.5.2.2](#) below.

- *Political risks*: These risks, especially at the global level, often have far-reaching economic and financial consequences, are real and largely impossible to predict, and are extremely difficult to assess. Examples include the terrorist attacks on the World Trade Center in New York in 2001, in Mumbai during 2008 and in Paris in 2015. Another example is the attacks on commercial shipping by pirates along the coast of Somalia in recent years. While difficult to predict, scenario analysis, as discussed in [Chapter 5](#), possibly provides the best approach to envisage possible future outcomes in uncertain environments. MNEs clearly should continuously assess the international political environment and, by extension, the geopolitical environment.
- *International law*: International law comprises a set of norms and rules that prescribe patterns of behaviour, including illegal conduct such as the expropriation of a foreign organisation's property without fair compensation, or the invasion by one country of another to expand its territory. Primary sources of international law are treaties and conventions, and can originate from 'custom' (international practice accepted as law) and recognised general principles or 'natural law' (the basis of human coexistence). The International Court of Justice in The Hague in the Netherlands is the principal judicial organ of the UN, and can adjudicate on issues between two countries. Since the Court has no formal authority to impose punitive measures, a system of sanctions exists that contributes to the coercive enforcement of international law.
- *Regional economic integration (REI)*: REI, discussed in [section 11.3.2.1](#) as a driver of globalisation, refers to groupings of countries in a region forming trade blocs or free trade areas (FTAs) by agreement. These groupings secure trade benefits for the participating member states through tariff-free or tariff-reduced cross-border movement of goods, services and resources, while imposing barriers on trade with non-members or third countries. The major strategic benefits of regional economic integration for international business include increase in market size, the free flow of resources and production factors among member countries, and common trade policies with regard to outsiders or non-member countries. By 2017 the EU included 28 countries, subject to Britain's impending withdrawal post-Brexit. The EU is currently the world's largest economic trade bloc with around half a billion people with an annual GDP far exceeding \$14 trillion. Trade and investment in the EU has become much easier since member states allow investors from other member countries to invest freely in and conduct business with organisations in their countries. Also, delivery times and transportation costs have been significantly reduced due to the elimination of customs controls at the borders between member countries.³⁸

Having briefly considered the more important political issues at the global level, political systems of individual countries and their importance for international business involvement are discussed in [section 11.5.3.1](#)

11.5.2.2 Economic

Economic growth or recessionary cycles worldwide or in major regions, global trade and investment trends, and evolving developments in the IMS all contribute to a global economic framework for identifying and evaluating emerging trends that are of strategic importance for international business operations. The global financial crisis experienced between 2007 and 2011 had a devastating effect on investor confidence, consumer demand and economic growth. The ensuing global recessionary cycle had far-reaching implications for business worldwide, including South Africa. However, it is well known that South Africa and most other emerging markets weathered the storm much better than most developed countries.³⁹ An important economic trend involves the ongoing growth in the number of MNEs with increasing FDI and networks of subsidiaries worldwide (see [section 11.3.2.3](#)). From a

global economic perspective, between 2000 and 2020 the value of world trade would have increased 3.3 times, whereas the world economy is expected to increase 2.6 times. This implies that by 2020 the value of world trade is expected to be 167 times greater than in 1960, while the world economy will only be 6.5 times larger. Average annual cross-border investment in terms of FDI also increased from \$14 billion in 1970 to \$1.45 trillion by 2016.⁴⁰

11.5.2.3 Sociocultural

Gradually changing national cultural values and norms as well as converging consumer preferences for many products and services globally have necessitated MNEs to adapt their international strategies to accommodate these changes, notwithstanding the fact that profound cultural differences between countries still prevail. Accordingly, cultural literacy and a global mindset have become indispensable for successful global cross-cultural leadership in the dynamic competitive global business environment. According to Cavusgil et al.,⁴¹ a vital element for the competitive advantage of an organisation, is to create a tolerant and empathetic environment when managing cross-cultural diversity.

This can be facilitated by researching and gathering accurate information about the culture of foreign colleagues. At the global business level, therefore, effective cross-cultural leadership is imperative in situations that require, for example:

- effectively communicating and interacting with foreign partners
- negotiating and structuring international business ventures effectively
- effectively interacting with current and potential customers abroad.

Culture and its implications for international business at the level of individual countries, including an overview of the determinants of culture and the implications of culture in the workplace, are explored further in [section 11.5.3.4](#)

11.5.2.4 Technological

Advances in technology at the global level were identified as one of the two main drivers of globalisation in the new economy ([section 11.3.2](#)). The internet, the world wide web, computer technology, biotechnology, genetic engineering, laser-optic technologies and artificial intelligence (AI) have revolutionised the ways in which industries are developing and international businesses operate.⁴² The implications of such developments are that they can render existing technologies and industries obsolete, but even more serious is the devastating effect of technology and, in particular, artificial intelligence (AI) on employment, as illustrated in the Case example *Five million jobs will be lost to AI by 2020 – WEF*.

CASE EXAMPLE: Five million jobs will be lost to AI by 2020 – WEF⁴³

The World Economic Forum (WEF) predicts that five million jobs will be lost by 2020 as the Fourth Industrial Revolution continues to transform labour markets. Many of the casualties will be repetitive manufacturing and mining tasks, and those considered dangerous for humans to perform, but white-collar jobs in banks and other services industries are also under threat. Robots and artificial intelligence (AI) can do these jobs faster and with greater precision than humans could ever hope to, leading to higher productivity and lower costs – the Holy Grail of business.

A study by Citi and the Oxford Martin School at the University of Oxford suggests that two-thirds of jobs in South Africa are at risk of being replaced by robots. We're already seeing South African financial services institutions such as Rand Merchant Bank and Nedbank replace thousands of hours of human labour with robotic process automation, a form of intelligent software automation. As these jobs disappear, we'll need to manage the transition to a new world carefully, especially in a country such as South Africa, with its rampant unemployment. The good news is that robotics and AI, like every technological revolution before them, will create new and higher paid jobs. We'll still need humans to operate these machines, to programme them and tell them what to do, after

all. And the productivity gains they create could be harnessed for the benefit of all. We'll need humans to create bigger, better robots and to make sense of the data the machines churn out. The organisation of the future can't operate without humans. Rather, it will be a safer, more efficient space where machines and AI augment the abilities and skills of humans, to increase output and reduce human error and injury. However, this means that skills such as communication, emotional intelligence, strategy, people management, stakeholder interactions, leadership, creativity and innovation, entrepreneurship, analysis and decision-making will become more in demand, across all industries.

Advances in information and communications technology have made the knowledge economy a reality, especially with regard to global communication, a critically important aspect in the coordination and control of global business operations. For example, communication internationally has become cheaper through data services such as WhatsApp and video calling using data services, such as Skype, WhatsApp calling and Apple Facetime. While both expensive and slow, South African internet bandwidth and speed are improving.

In summary, the macroenvironment at the global level in the political-legal, economic, sociocultural and technological areas has been selectively addressed merely as an indication of environmental trends and forces at this level. It is obvious that many political-legal, economic and social factors, including demographic trends, natural environmental issues and physical factors are interrelated, and that these forces and trends affect some industries more than others at any given point in time.

11.5.3 Macroenvironmental analysis of countries

Countries have their own unique political, legal, economic and sociocultural systems, and also differ as far as demographics, geography and physical characteristics are concerned. Based on our earlier discussions ([section 5.2](#) in [Chapter 5](#)), we now focus on country-level analyses of importance in international strategic planning.⁴⁴

11.5.3.1 The political environment

Almost without exception, governments have a profound impact on the success or otherwise of international organisations operating in their countries. Governments may encourage foreign business involvement by means of attractive opportunities for investment and trade, or discourage such involvement for whatever reason through unfavourable legislative and policy restrictions. Importantly, a government's attitude toward foreign business involvement is largely determined by its political ideology as well as its political and legal systems, which in turn shape a country's economic system.

A **political system** is defined as a system of government in a nation, and political systems are characterised according to two dimensions: (1) the degree to which they emphasise individualism as opposed to collectivism; and (2) the degree to which they are democratic or totalitarian. **Individualism** is an ideology characterised by an emphasis of the primacy of the individual's freedoms within the political, economic and cultural contexts of a country. Individualism leans towards an advocacy for democratic ideals and free market economics. **Collectivism**, in contrast, is an ideology that sees the needs of society as being more important than those of individuals. Collectivism leans towards an advocacy for state intervention in economic activity and, in the case of communism, a totalitarian dictatorship. These dimensions are interrelated – individualism tends towards democracy, whereas collectivist systems tend towards totalitarianism.⁴⁵ The dominant political systems in the world today include democracy, totalitarianism, socialism, communism and theocratic totalitarianism, defined as follows:

- *Democracy*: a political system where government is by the people, either directly or indirectly through elected representatives (the South African political system is based on a constitutional democracy)
- *Totalitarianism*: a form of government in which one person or political party exercises absolute control over all spheres of human life and prohibits opposing political parties

- *Socialism*: a system where the state owns the means of production and manages state-owned enterprises to the benefit of society rather than individual capitalists or entrepreneurs
- *Theocratic totalitarianism*: a system where political power is monopolised by a party, group or individual that governs according to religious principles.⁴⁶

The political philosophies and systems of countries referred to above represent the potential for varying degrees of government intervention and hence political risk. The various types of exposure to political risk can be broadly classified according to legitimate government actions and those events caused by actors outside government control. Actions of legitimate government authorities may include:

- military conflict
- nationalisation of industries or industry sectors
- expropriation of land and assets, including the violation of intellectual property rights
- forced divestiture and confiscation
- restrictive licensing policies
- restricting access to financial, labour, commodity and materials markets
- restricting repatriation of capital and profits to parent companies in their home country
- exchange controls
- value-added or export performance requirements.
- unexpected changes in laws and regulations unfavourable to foreign businesses, evident from the Case example *DRC's new mining code is in force*.
- absence of the rule of law
- poor law enforcement, unforeseen contractual disputes and unfair cancellation of contracts, as evidenced from the Case example *DRC's new mining code is in force*.

Events caused by actors outside government control may include:

- war and revolution
- terrorism
- extortion
- strikes and civil disorder
- threats or disruptions to operations by hostile groups
- externally induced financial constraints
- externally imposed limits on imports or exports
- illegal occupation of property.

Information gained from environmental scanning should enable international managers to decide on issues such as a foreign country's degree of political stability, its potential political risk, the government attitude towards foreign business, the ease of doing business, and whether enhancing industry incentives exist in the foreign countries concerned. Approaches to identify, assess, respond to and manage various types of political risk are discussed below.

CASE EXAMPLE: DRC's new mining code is in force⁴⁷

Miners operating in the Democratic Republic of Congo (DRC) would not secure substantial concessions in talks with the state about changes to the industry code, a senior mining official said. Mining companies, including Glencore and Randgold Resources, are pressing the government to row back on some of the reforms President Joseph Kabila signed into law earlier in March 2018.

The modifications will raise taxes and other costs for operators in the DRC, Africa's top copper producer and the world's main source of cobalt. 'There can be no renegotiation on any point once the code has been

promulgated,' Albert Yuma, the chairperson of state-owned mining company Gecamines, said in an e-mailed response to questions later in March. Kabila met top executives from major foreign investors in early March to discuss their objections to the new law, which was approved by parliament in January 2018. The president signed the code on 9 March 2018, but assured miners that 'their worries will be taken into account' in talks with government. Representatives of Glencore, Randgold, China Molybdenum, Ivanhoe Mines, MMG, Zijin Mining Group and AngloGold Ashanti attended the meeting. The revised code removed a measure protecting mining licence holders from complying with changes to the fiscal and customs regime for 10 years, which meant that all mines would face higher royalty payments and new taxes. The new law also introduces a 50% tax on so-called super profits and hikes royalty rates on metals, including copper, cobalt and gold. It also allows the government to raise royalty payments on cobalt five-fold to 10% if it opts to categorise the metal as a 'strategic substance'. 'The taxes and royalties to be paid have been fixed in the code by law,' said Yuma, who took part in the meeting on 7 March. 'No one can any longer change or remove them, or create new ones.'

The companies that met Kabila sent a team to the DRC capital, Kinshasa, ahead of the talks with the mining industry, according to a joint statement on 15 March. The ministry is required to produce regulations within 90 days of the law's promulgation, which will dictate how the code will be implemented. The companies said Kabila assured the industry their questions would be resolved through 'transitional arrangements' and the regulations. The miners expected that the negotiations would 'give priority to the recognition' of the decade-long stability clause contained in the previous legislation which was adopted in 2002 and which 'formed the basis of many investment decisions' taken by the companies. They also said they confirmed to Kabila 'their willingness to negotiate additional royalties and changes to other taxes' during the talks. Such wide-ranging was not up for discussion, according to Yuma. 'The mining regulations do not have the vocation or the power to modify the articles of the code,' he said. After Kabila met the executives, Mines Minister Martin Kabwelulu told reporters that the government 'will take the measures of the code and put them in regulations' and that 'the law cannot be contradicted'. Kabwelulu did not immediately respond to a request for clarification about what issues will be on the table in the upcoming talks. His chief of staff, Valery Mukasa, declined to comment before the discussions have started.

As far as effectively coping with political risk, MNEs should be able to identify, assess and manage political risks at the global level and especially at individual country level, since political risks around the world typically originate from unanticipated interventions by governments and the unpredictability in political systems. However, as stated above, risks could also originate from external, non-governmental related forces around the world. One approach is to develop appropriate strategies based on macro political risk analysis and micro political risk analysis.⁴⁸ **Macro political risk analysis** reviews all major political decisions likely to affect all enterprises in the country, for example India's prohibition of foreign wholly-owned subsidiaries in the retail sector, yet allowing joint ventures with local Indian counterparts, and China's restriction on foreign exchange transactions, both examples where all MNEs are affected. **Micro political risk analysis** is directed towards government policies and actions that influence selected sectors of the economy or specific foreign businesses within an industry or industries in the country, for example restrictive regulations of a country's telecommunications industry, and restrictive labour laws in selected industries such as mining and exploration.

Given the typical unpredictability of political risk, MNEs could mitigate potential risks before they appear by proactively fostering good relationships with foreign governments. In this regard, Luthans and Doh have identified three related strategies that should be considered: (1) relative bargaining power analysis; (2) integrative, protective and defensive techniques; and (3) proactive political strategies.⁴⁹

Relative bargaining power analysis relates to the MNE attaining a stronger bargaining power position than the host country by, *inter alia*, providing proprietary technology or expertise that will be lost to the country should the company have to withdraw for whatever reason. The second strategy (integrative, protective and defensive techniques) involves integrating the company's operations to become part of the country's infrastructure, or adopting protective and defensive techniques designed to discourage host government interference by limiting local

production, conducting research and development elsewhere, limiting the responsibility of local personnel, raising capital from local banks, and diversifying production over a number of countries. The third strategy (proactive political strategies) basically relates to situations where many developing country governments are still characterised by dictatorships clinging to power and overturning or reneging on past deals and contracts. The Case example *DRC's new mining code is in force* above would fall in this category. This third strategy firstly requires pre-emptive building of good relationships with governments through lobbying and identified stakeholders, as well as community involvement where risks cannot be insured against. In addition to building relationships and lobbying, proactive political risk strategies include partnering with local firms; leveraging bilateral, regional and international trade and investment agreements; using bilateral and multilateral financing; and using project finance structures to minimise firm risk. As part of this strategy, MNEs can also turn to campaign financing and related interventions to shape and positively influence political decisions prior to their impact on the company.⁵⁰

The success or failure of international organisations largely depends on how well their international strategies have been adapted to effectively accommodate the implications of political risks in foreign markets.

11.5.3.2 The legal environment

The **legal system** of a country is influenced by the prevailing political ideology and political system since the government defines a country's legal framework within which organisations conduct business. The context of the legal environment that international organisations face comprises of the following:

- The domestic laws of the international organisation's home country (see [Chapter 5](#))
- The legal systems of the countries in which the organisation is involved
- International law (discussed in [section 11.5.2.1](#)).

A domestic company will rarely, if ever, be affected by the latter two dimensions, but international organisations have to contend with the complexity of different legal systems in their foreign locations. Differences in legal systems among countries can influence the attractiveness of a country as a destination for foreign investment and trade.

Hill⁵¹ states that collectivist-inclined totalitarian states tend to enact laws that severely restrict private enterprise, while laws enacted by democratic governments where individualism is the dominant political philosophy tend to favour private enterprise and a free market system.⁵² International managers must therefore be familiar with the legal systems of the countries in which they operate as well as other legal relationships that may exist between countries, such as bilateral and multilateral agreements or treaties to which a country is partner, for example reciprocal tax treaties between countries.

The three prominent **legal systems**, approaches and traditions in use around the world – common law, civil law or code law, and theocratic law – are defined as follows:⁵³

- *Common law*: The common law system is practised in the British Commonwealth (including South Africa), the US and most other Anglo-Saxon countries. It is based on tradition, precedent, and custom, and interpretation of the law is an important aspect in this system.
- *Civil law or code law*: A civil law system is based on detailed sets of laws organised into codes. More than 80 countries in Western Europe, parts of Asia, and Russia have a civil law system that is much less flexible than common law. Also, application of the law is more important than its interpretation when compared to common law.
- *Theocratic law*: A theocratic law system is based on religious principles and teachings, with Islamic law the most widely practised theocratic law system worldwide. The Qur'an (Koran) forms the foundation of Islamic law. The payment or receipt of interest is considered usury and is unacceptable according to the Qur'an, as illustrated in the Case example *Islamic banking and finance*. In Islam, theology and law are totally integrated, and also permeate economic ideology.

CASE EXAMPLE: Islamic banking and finance⁵⁴

Pakistan's Federal Sharia Courts, its highest Islamic legislative body, pronounced that interest is un-Islamic and therefore illegal. As a result, the government had to amend all financial laws accordingly. In 1999, Pakistan's Supreme Court ruled that Islamic banking methods should be used as from July 2001. By 2008, some 500 Islamic financial institutions in the world, including those in the Gulf States, Egypt and Malaysia, already managed more than \$500 billion in assets. By 2010, the total assets of Islamic banking exceeded \$1 trillion. In 2006, Absa Bank announced the introduction of Islamic banking procedures, and was soon followed by other major commercial banks in South Africa. By 2018, South African banks that offered Islamic banking included Absa Bank Limited, Standard Bank, FirstRand Bank Limited, elBaraka Bank, and 4B2 Bank Limited. The worldwide initiative to introduce Islamic banking confirms the importance of accommodating different customs in the interest of international business.

International law as discussed in [section 11.5.1](#) provides broad guidelines for international business conduct in keeping with generally accepted customs and rules.

11.5.3.3 The economic environment

[Chapter 5](#) discussed the economic environment and its importance in strategic planning for international businesses. Analysis of the economic environment at the global and, more specifically, at the country level is necessary to assess the potential benefits, costs and risks of locating some of a MNE's productive operations in other countries, and to identify economically viable opportunities for the MNE's products and services in those countries. The potential benefits of doing business with or investing in another country is therefore largely determined by a country's:

- market size (essentially the size of its population)
- current wealth (purchasing power of the population)
- future economic prospects.⁵⁵

International management needs to understand the prevailing economic systems in foreign countries, and evaluate economic growth, employment levels, income levels, monetary and fiscal trends, as well as industry and market trends for each country in which the organisation is involved. Where rapid economic growth is experienced, sales prospects for consumer goods are generally more promising.

Typical **economic systems** include market economies, command economies, and mixed economies as explained below:

- *Market economy*: In a market economy, the majority of a nation's land, productive facilities and other economic sources are privately owned.
- *Command economy*: In command or centrally planned economies, land, productive facilities and other economic resources are owned by the government, which also plans most of the country's economic activity. The collapse of many command economies since 1989 is attributed to poor economic performance and the failure to create wealth.
- *Mixed economy*: A mixed economy is an economic system in which land, productive facilities and other resources are more equitably distributed between the private sector and government ownership compared to a command economy. This largely applies to South Africa.

Gross national product (GNP) and gross domestic product (GDP) are relatively similar measures of a country's economy. As stated in [Chapter 5](#), GNP and GDP are not suitable for the direct comparison of country economies because countries differ in terms of the size of their economies, level of economic development, and size of their population. While nominal GNP and GDP per capita (not adjusted for cost of living) do provide comparable data,

these measures, adjusted for cost of living or purchasing power parity between countries, provide much more useful data in terms of GNP and GDP per capita for comparison purposes.

The classification of countries by level of income is important when evaluating the economic attractiveness of countries. [Table 11.1](#) illustrates the World Bank classification of economies in terms of per capita GNI (GNP), adjusted for purchasing power parity.

Table 11.1 Classification of countries in terms of per capita GNI, adjusted for purchasing power parity, 2016⁵⁶

Classification	Per capita GNI
Low-income countries	\$1 025 or less
Lower middle-income countries	\$1 026 – \$4 035
Upper middle-income countries	\$4 036 – \$12 475
High-income countries	\$12 476 or more

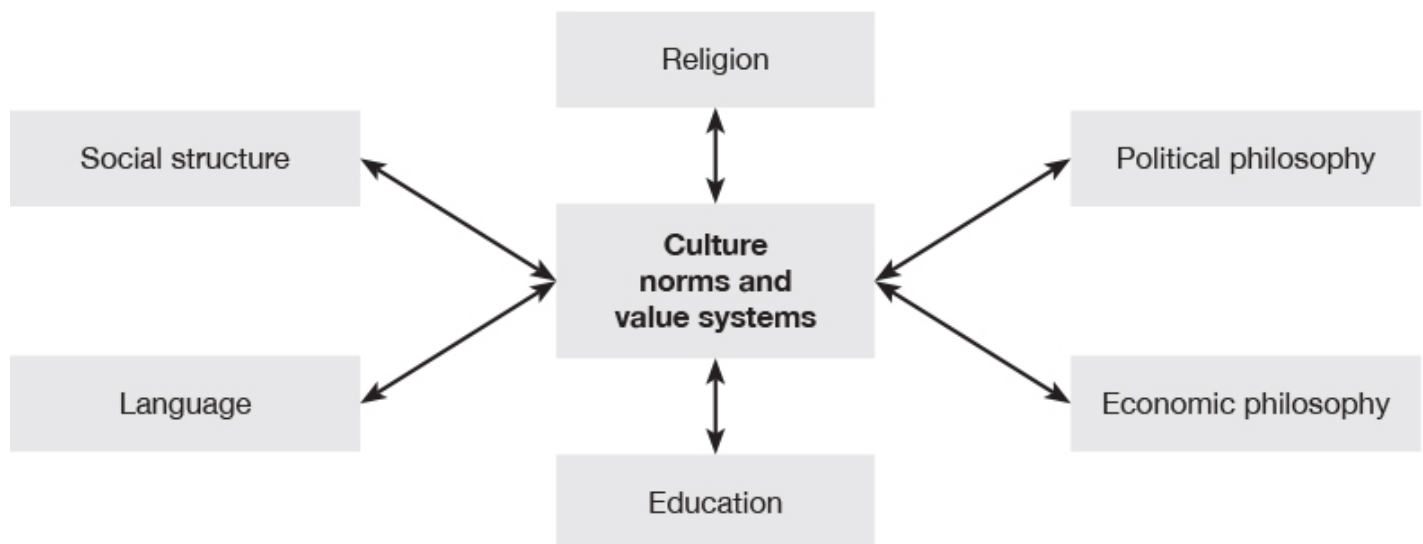
Analysis of the economic environments of those countries in which an organisation is involved provides important information, often identifying country-specific advantages (CSAs) for international strategic planning.

11.5.3.4 The sociocultural environment

[Chapter 5](#) introduced the sociocultural environment. This section focuses on a concise interpretation and evaluation of the cultural environments facing international business by defining what culture is, identifying the determinants of culture and their implications for international business, and exploring how culture relates to values in the workplace.

For our purposes we define **culture** as the outcome of human behaviour based on pervasive and shared norms, values, attitudes and beliefs that people use to interpret experience and generate social behaviour that guides their lives as individuals or as members of a group. The most important determinants of the culture of a nation, society or group are political philosophy, economic philosophy, social structure, religion, language and education, as illustrated in [Figure 11.3](#).

Figure 11.3 The elements of culture⁵⁷



While these determinants influence the values and norms of a culture, they are interrelated and are, in turn, influenced by culture as it evolves over time. Important implications of culture for international business based on the influences of its determinants are selectively summarised below:⁵⁸

- Political philosophy
 - » Political philosophies and systems of countries shape their legal and economic systems.
 - » The political philosophies of countries such as Switzerland, Canada, Cuba, Iran and Zimbabwe clearly differ in many respects, also with regard to perceived political risk.
- Economic philosophy
 - » Whether a country has a market economy, a mixed economy or a command economy affects economic, investment, social and ethical behaviour differently.
 - » Countries adhering to a free market philosophy and democratic principles that encourage individual initiative and an entrepreneurial orientation, and that also protect property rights are decidedly more attractive for foreign investments and international business compared to a command or even a mixed economy.
- Social structure
 - » Countries characterised by distinct social strata such as the caste system in India, with little or no mobility of people between strata, pose serious challenges for, *inter alia*, international human resource management in areas such as staff appointment, promotion and reward.
- Religion
 - » By 2016, major religions and their following in the world were Christianity with 2 200 billion, Islam with 160 billion, Buddhism with 535 million, Judaism with 18 million and Hinduism with 1.1 million followers.
 - » Religion influences a society's attitude towards initiative, work and wealth creation. For example, there is the Protestant ethic of entrepreneurship, hard work, productivity, saving and wealth creation. Hinduism emphasises spiritual accomplishments rather than wealth and material well-being. Islam supports capitalism, has a strong emphasis on social responsibility, and prohibits the receipt or payment of interest. Buddhism emphasises both spiritual accomplishment and material well-being.
 - » In Muslim countries, for example, religion is a constraint on gender issues to date, limiting career opportunities and the mobility of women, as well as subordinating them to men.
 - » Religion influences dietary habits and consumption patterns. For example, pork products and alcohol are forbidden in Muslim countries, as is beef in India.
- Language
 - » It is estimated that there are more than 6 000 different languages and more than 10 000 dialects spoken worldwide with Chinese the mother tongue of the largest number of people worldwide, followed by English and Hindi. English is the most widely spoken language in the world, influenced, *inter alia*, by the internet.
 - » Language involves both spoken (verbal) and unspoken (non-verbal) communication. Non-verbal communication is believed to constitute 80–90% of all communication, and includes hand gestures, facial expressions and interpersonal distance.
 - » Language is of extreme importance to international business in areas such as international negotiations and contracts, marketing, promotion and advertising, where incorrect translations of advertisements and notices could damage the image of an organisation, as highlighted in the Case example *Signs from all over the world*.

CASE EXAMPLE: Signs from all over the world⁵⁹

Signs and notices in English found in various countries throughout the world:

- *In a Bucharest hotel lobby:* The lift is being fixed for the next day. During that time we regret that you will be unbearable.

- *In a Paris hotel lift: Please leave your values at the front desk.*
- *In a Japanese hotel: You are invited to take advantage of the chambermaid.*
- *Outside a Hong Kong tailor shop: Ladies may have a fit upstairs.*
- *In a Rome laundry: Ladies, leave your clothes here and spend the afternoon having a good time.*
- *In a Copenhagen airline ticket office: We take your bags and send them in all directions.*
- *In a Norwegian cocktail lounge: Ladies are requested not to have children in the bar.*
- *In the office of a Romanian doctor: Specialist in women and other diseases.*
- *At the reception desk of a Greek hotel: We will execute customers in quick rotation.*
- *In a Czech tourist office: Take one of our horse-driven city tours – we guarantee no miscarriages.*
- *In a Bangkok dry cleaner's shop: Drop your trousers here for best results.*

- Education In the context of international business, education is important for reasons that include the following:
 - » Both formal and informal education are extremely important in shaping culture and passing it on from one generation to the next.
 - » Porter⁶⁰ maintains that education is a determinant of national competitive advantage.
 - » In international business, the extent and levels of education are important because they reflect the knowledge and sophistication levels of a society. This is important for marketing, as well as the availability of skills and competencies for MNEs in deciding where to locate foreign operations.

Since the culture of a nation, society or group determines the behaviour of their members, based on their norms and values, international leaders and managers should possess profound cross-cultural literacy and adapt their strategies to meet the needs and buying behaviours of people from different cultures.

However, how culture relates to values in the workplace is of critical importance to a MNE involved in a number of different countries, Hofstede investigated how a society's culture affects the values in the workplace which would aid international managers to adapt their processes and practices to accommodate cultural differences in the workplace. Hofstede ultimately identified the following six cultural dimensions, which we now briefly discuss:⁶¹

- *Individualism versus collectivism:* A society characterised by individualism emphasises individual freedom and self-expression, individual achievement, recognition and reward, as found in the US, whereas collectivism emphasises collective societal goals as opposed to individual goals, pursuing group achievement and group recognition, mainly for the greater good of society, and striving for group harmony, as found in China and countries in the Middle East.
- *Power distance:* This describes how a society deals with the unequal distribution of power among people. Societies characterised by high power distance are typically autocratic, and the difference between the more powerful and less powerful is accepted. In societies with low power distance, the gap between the powerful and the less powerful is played down as much as possible and greater openness exists. Brazil and India are characterised by high power distance, while low power distance is found in countries like New Zealand, Sweden and the US.
- *Uncertainty avoidance:* This determines the extent to which societies accept and tolerate risk and uncertainty as opposed to those that are predominantly risk averse, avoid ambiguity and favour security. Whereas the US is characterised by low uncertainty avoidance, Japan is characterised by high uncertainty avoidance.
- *Masculinity versus femininity:* This dimension refers to the relationship between gender and work roles where masculine societies favour material wealth and are ambitious and assertive, whereas societies characterised by femininity emphasise interdependence, interpersonal relationships, caring and nurturing. High masculinity prevails in countries like Japan and Germany, while the Netherlands and Sweden are characterised by low masculinity.

- *Short-term versus long-term orientation*: This dimension differentiates between societies, including groups and organisations within societies that adhere to short-term objectives, results and timeframes as opposed to longer-term perspectives and objectives, based on the future rather than the present. The US and Australia are characterised by having a short-term orientation, whereas a long-term orientation prevails in countries like Brazil and Japan.
- *Indulgence versus restraint*: This cultural dimension of a nation or society is closely related to the short- and long-term perspectives, where indulgent societies favour instant social and financial gratification compared to societies with a long-term orientation exhibiting restraint through patience, delayed gratification and intent on saving for the long term. Most Western countries are seen as indulgent, while most Eastern and Southeast Asian countries are seen to exhibit restraint.

These dimensions have been widely accepted, and although cultures do evolve over time, the above dimensions provide a useful framework for managing foreign operations, especially as far as organisational behaviour and human resource practices in international settings are concerned.

In this section we highlighted the importance of understanding culture in international business, and of scanning the international cultural environment when devising international strategies. We concluded by highlighting the importance of culture and its implications in the workplace for international business.

11.5.3.5 The technological environment

[Chapter 5](#) covered this topic extensively. [Section 11.3.2](#) identified technological development as one of the major drivers of globalisation. It is imperative that international management be acutely aware of technological advances, especially those related to their specific industries and keep the following, *inter alia*, in mind:

- Dramatic innovations may render an organisation's own technologies obsolete, resulting in a serious competitive disadvantage.
- Advances in transport vehicle technology, such as electric and self-driving cars (these developments were briefly discussed in [Chapter 5](#)) must be taken into consideration.
- Innovation could lead to the creation of entirely new industries, requiring management to be aware of the four possibilities of industry change, namely radical change, intermediating change, creative change and progressive change.⁶² Technologies, such as the internet, related ICT developments, robotics and artificial intelligence, have increased the importance of the knowledge economy exponentially.
- The internet has revolutionised many business practices from design, access and production to distribution, while eliminating political and other barriers to trade.
- A sub-field of AI – machine learning – has come to be used for everything from working out how best to aim advertisements at web surfers to how to develop self-driving cars. In fact, it seems that the inconceivable may become reality where, for example, fully automated surgery is expected around 2050, independent AI research by 2104, and full automation of labour by 2140.⁶³

In summary, the ability to create, develop and apply new technologies, or revolutionise existing ones, is fundamental to organisations of every size and type, and should be part of an organisation's strategic intent, vision and scenarios for the future.

11.5.4 The industry environment

Porter's five forces model (potential entrants, substitutes, suppliers, buyers and competitive rivalry) to determine the long-term profit potential of an industry has been extensively covered in [Chapter 6, section 6.2.2](#). While two other forces, that of complementary products or services and government, have been added to Porter's five forces.

Government regulators and intervention, as the last-mentioned force, especially have become increasingly important in the international domain for the following reasons:

- Government licensing policies and other regulatory factors increase barriers to entry.
- There is greater protection of suppliers' bargaining power in protected economies where materials could be in the hands of state monopolies.
- Buyers' bargaining power may also be greater where distribution networks are tightly controlled.
- Government actions such as discriminatory or selective taxation and price controls may influence the profitability of some industries compared to others.⁶⁴

11.5.5 Summary

In this section we noted that the macroenvironment manifests itself at the global level and at the level of individual countries. Environmental scanning and analysis in international business should therefore include evaluation of the global, country and industry level environments for international strategic planning purposes. We now turn to the all-important concept of competitive advantage in an international business context.

11.6 International competitive advantage

As previously stated, organisations that have a distinctive domestic competitive advantage and possess a valuable set of resources that can be leveraged into new markets can consider becoming active international players by either exploiting or enhancing their existing domestic competitive advantage.⁶⁵ This discussion is followed by Porter's concept of national competitive advantage as a framework for internationalisation.

11.6.1 International competitive advantage in a global context

Irrespective of whether an MNE pursues a differentiation or a low-cost generic competitive strategy in its home market, its **international competitive advantage** is the result of either one or both of the following two motivations⁶⁶ (see sections 11.4.1 and 11.4.2.2):

- By exploiting its distinctive domestic competitive advantage, also referred to as its firm-specific advantage (FSA) – which could include a superior product or service, unique processes, or capabilities that are superior to those of the MNE's competitors in its foreign markets – to increase its scope and profitability through market seeking which includes successfully exporting its products to foreign markets.
- By enhancing the MNE's distinctive domestic competitive advantage through the location of its subsidiaries and thus its production activities in foreign countries by means of FDI, motivated by resource seeking rather than, or in addition to, market seeking. The focus here is on factor markets in foreign countries, such as the cost-effective availability and potential benefits of resources such as capital, labour and raw materials (the factor endowments) in order to capitalise on lower factor costs in these foreign countries to attain country-specific advantages (CSAs).

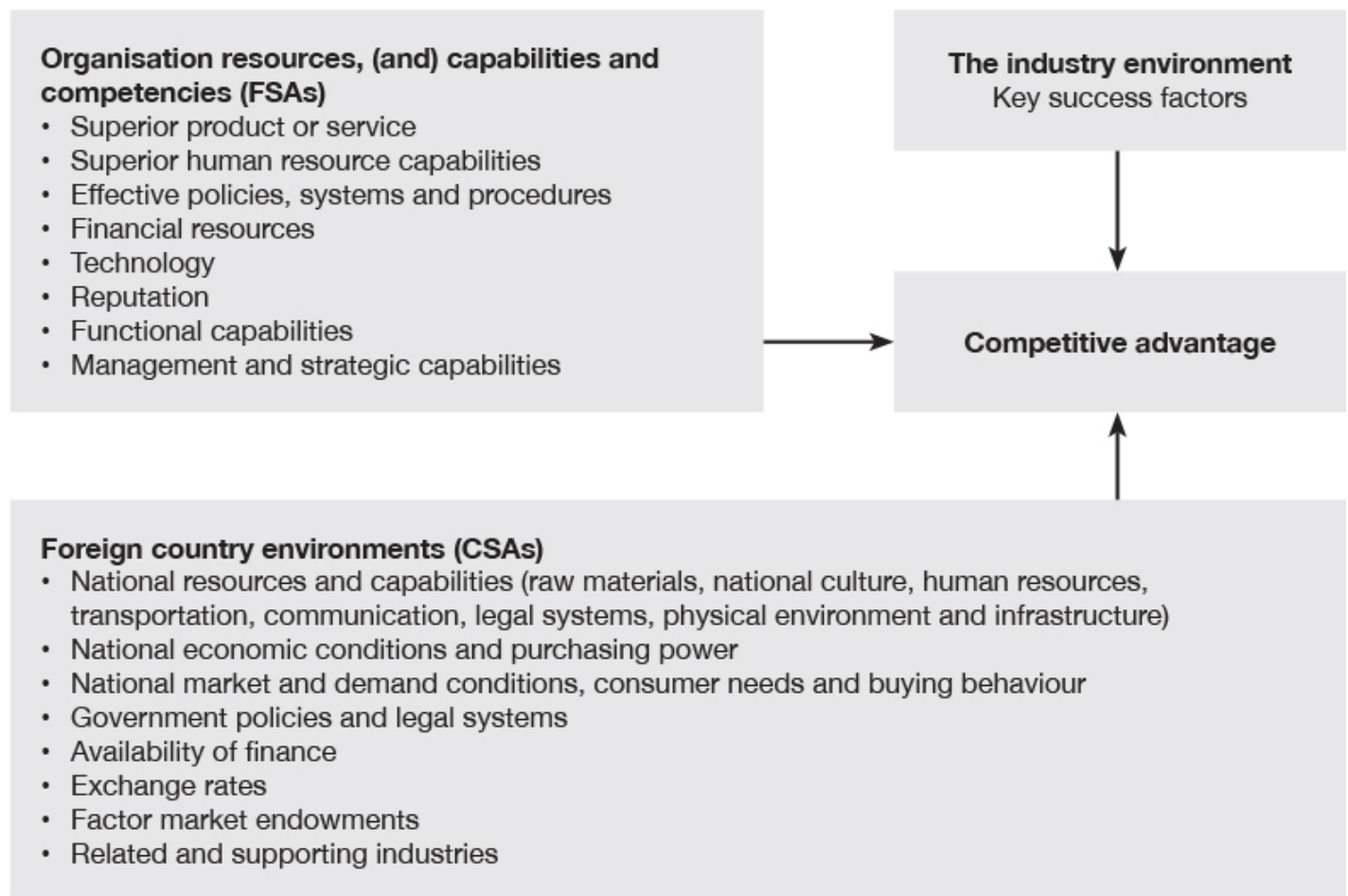
However, an MNE's foreign subsidiary could serve other foreign markets, and even its home market, by exporting the products or services it produces from its foreign location.

Closely aligned to the combined effect of FSAs and CSAs is Dunning's Eclectic Paradigm, based on ownership-specific advantages (O), location-specific advantages (L) and internalisation advantage (I) – his so-called OLI paradigm.⁶⁷ Ownership-specific advantages derive from an organisation's knowledge, skills, capabilities, processes and physical assets, and are similar to FSAs. Location-specific advantages derive from factor endowments in

individual foreign countries which include natural resources, skilled labour, low-cost labour and low costs of financing, and are comparable to CSAs. Internalisation advantages stem from the organisation's involvement in optimising and controlling its activities, and keeping some of its international value chain operations within the control of the firm.

Given that an MNE's subsidiaries would compete in the same industry abroad as at home, the competitiveness of these subsidiaries, located in the various foreign countries, would largely depend on the extent to which they perform better than their immediate competitors in those foreign countries in terms of relevant industry key success factors (KSFs). The relationship between FSAs, CSAs and industry competitiveness, in terms of KSFs as sources of an MNE's international competitive advantage, is illustrated in Figure 11.4.

Figure 11.4 Competitive advantage in an international context⁶⁸



For viable international strategies, international managers should be acutely aware of the sources of international competitive advantage relevant to their own specific situations.

11.6.2 National competitive advantage

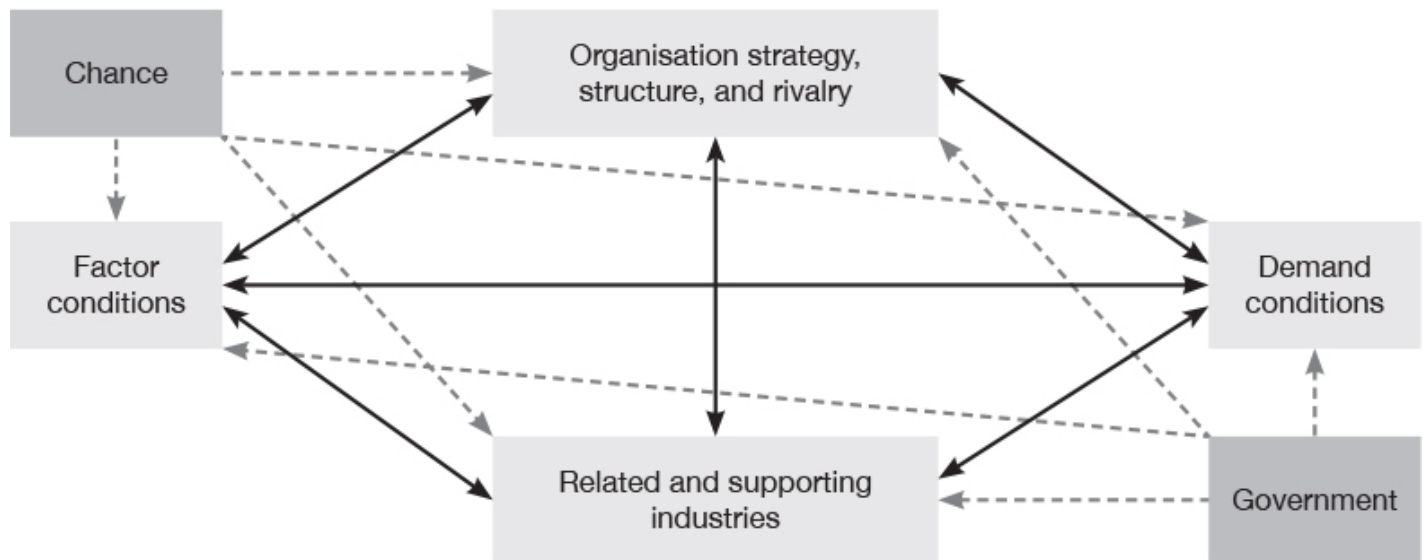
Porter⁶⁹ found that the success of nations, industries and individual business organisations were closely linked and that **national competitive advantage** originates from the internal strengths of successful domestic organisations that innovate and continually improve their processes and refine their strategies within their industries to the extent that their superior product and service offerings become internationally competitive. However, according to Porter,

national competitive advantage is determined in combination with the following four attributes that he originally identified, and the additional two that he subsequently included in his model:

- Factor conditions
- Demand conditions
- Related and supporting industries
- Organisational strategies, structures and rivalry in the organisation's domestic environment.

Porter subsequently included the role of government and chance events as two additional attributes in his model of national competitive advantage, as illustrated in [Figure 11.5](#).

Figure 11.5 Porter's diamond of national competitive advantage⁷⁰



11.6.2.1 Factor conditions

Porter⁷¹ distinguished between basic and advanced factors in a country. Basic factor endowments comprise natural resources, climatic conditions and the basic skills of the workforce, whereas advanced factor endowments include the high-level skills of the labour force, knowledge resources, capital, infrastructure and advanced technologies.

A country such as Japan has minimal basic factors, especially raw materials necessary for manufacturing, most of which it has to import. However, it has an abundance of advanced factors that include highly skilled people and high-level technologies which are continuously improved, especially in vehicles, robotics and consumer electronics, to enhance national and international competitiveness.

South Africa is richly endowed with basic factors such as minerals and has ample basic workforce skills. It also has an encouraging endowment of advanced factors such as highly skilled people in commerce and industry, a world-class financial infrastructure and banking system, and cutting-edge technologies in deep-level mining and oil-from-coal production technologies where Sasol is a world leader.

11.6.2.2 Demand conditions

According to Porter, national competitive advantage is also strengthened by a strong local demand for industries' goods and services, and the degree of sophistication of that demand. These conditions are the primary drivers for innovation, quality improvement and competitiveness in the domestic market, and provide firms with an excellent springboard for expanding competitively into international markets.

11.6.2.3 Related and supporting industries

The presence of related and supporting industries that are internationally competitive can help organisations to increase their competitive advantage through innovation and quality improvement. These are typically industries that supply components and are generally located near producers, are able to provide inputs at lower costs compared to more distant suppliers, and can adapt rapidly to the changing needs of producers.

11.6.2.4 Organisation strategy, structure, and rivalry

Porter's research confirmed that nations tend to do well in those industries characterised by intense rivalry where management practices and strategies of organisations are closely aligned to the industry's key success factors and sources of competitive advantage. This attribute of Porter's diamond relates directly to the quality of strategic management of individual organisations.

11.6.2.5 Government and chance events

In addition to these four attributes, Porter⁷² subsequently added the role of government and chance events as attributes that could affect national competitive advantage. We have seen that governments can enhance or restrict international business. Restrictions could result from unacceptable delays in the issuing of licences and permits for involvement in certain industries abroad such as telecommunications, air transport and the liquor industry. Unanticipated regulatory changes, for example related to a country's mining industry, illustrated in the Case example *DRC's new mining code is in force* in [section 11.5.2.2](#) would have a serious negative impact on attracting foreign investors. However, governments can also create an enhancing environment by way of incentives such as the alleviation of taxes and the provision of export incentives.

Examples of chance events include the earthquakes in Haiti in January 2010 and in Chile in March 2010. Atmospheric ash from the volcanic eruption in Iceland in April 2010 had a disastrous effect on the global airline industry when airports in the UK and across Europe were closed for more than a week. This resulted in losses of hundreds of billions of rand for, *inter alia*, commercial airlines serving the affected destinations. Such events typically have catastrophic effects on business in a specific region or even further afield, as is evident from the example of the volcanic eruption in Iceland.

Importantly, the four original attributes need to be positive and support each other to provide the ideal business climate for organisations to internationalise. While Porter's work has not been free of criticism, it is still extensively used in the context of international strategy.

11.6.3 Summary

International competitive advantage of MNEs, on the one hand, typically commences with domestic competitive advantage through unique product differentiation and superior customer value creation, performance, quality and branding, or, on the other hand, from value creation and competitiveness through greatly efficient low-cost leadership, enhanced by mutually supportive, positive attributes of national competitive advantage. The extent to which MNEs are able to capitalise on country-specific advantages (CSAs) in their foreign markets will further contribute to their overall sustainable international competitive advantage, as is evident from the interrelationships in [Figure 11.4](#).

International competitive strategies to exploit these advantages are discussed in the section that follows.

11.7 International competitive strategies

In the previous section we identified the more important sources of competitive advantage for organisations involved in international business. To succeed in the dynamic and competitive global business environment, organisations need to have viable strategies based on a clear strategic intent, vision, mission and long-term objectives that are aligned to and reflect the organisation's intended international involvement.

We now consider the different international strategies that organisations can pursue in their quest for international competitive advantage. These include:

- an international strategy
- a multidomestic or localisation strategy
- a global strategy
- a transnational strategy; or
- combinations of these strategies.⁷³

Before proceeding, we briefly consider the **strategic orientation** (DEF30) of international organisations as a frame of reference for international strategic planning. The strategic orientation involves an organisation's cultural strategic predisposition, whether an ethnocentric, polycentric, regiocentric, or geocentric predisposition toward its international business involvement as a frame of reference for its international strategic planning and operations.

11.7.1 Strategic orientation of international organisations

Multinational enterprises typically display one of four orientations, sets of beliefs or mindsets toward their international and global activities. These include an ethnocentric orientation, a polycentric orientation, a regiocentric orientation or a geocentric orientation:⁷⁴

- An organisation with an ethnocentric orientation believes that everything that originates from its home country is best, and that the values and priorities of the parent organisation must guide the strategic decisions regarding all its foreign operations. Control is mostly centralised, products standardised where feasible, and subsidiaries generally staffed with key managerial personnel from the parent organisation in the home country.
- In a polycentric orientation, the culture of the country in which a subsidiary or foreign operation is located receives priority and dominates decision-making. Foreign subsidiaries accordingly enjoy relatively greater freedom, the entire MNE is highly decentralised, and subsidiaries are predominantly staffed with people from the host country familiar with local market and operating conditions.
- In a regiocentric orientation, the predisposition of the parent organisation is largely blended with those of its subsidiaries or operations in other countries within a region, thus accommodating regional influences.
- An organisation with a geocentric orientation adopts a globally integrated systems and networking approach to strategic decision-making, exhibits a worldwide attitude, and encourages multiculturalism and global learning. Decisions are made at the parent organisation level as well as in foreign subsidiaries as circumstances dictate. In this orientation the best person for the job is appointed in host country subsidiaries, regardless of nationality, race, religion and gender.

As will be clear in our exposition on international strategies, strategic orientation plays an important role in the strategic priorities and the structuring of international organisations.

11.7.2 Competitive advantage and strategy

Pursuing international strategies successfully can dramatically help organisations to extend their competitive advantage to new foreign markets, resulting in greater profitability. As outlined in [section 11.6.1](#) above, this is achieved by MNEs effectively leveraging their distinctive competencies, capabilities and resources, and capitalising on factor market advantages in their foreign markets. As previously stated, Porter's competitive generic low-cost and

differentiation strategies pursued in an MNE's home market provide the basis for the four international strategies, depending on the types of product or service involved – whether products or services could be sold worldwide without any customisation or adaptation, or whether they need to be customised or adapted for distinct national markets.

In the former case, organisations are bound to experience pressures for cost reductions, since they will be competing on cost and price rather than on differentiated features of products or services. However, where an organisation's products or services will not be accepted without customising them for local preferences, the organisation will be subject to, and will need to accommodate the pressures for local responsiveness to be competitive. These pressures and their implications for deciding on appropriate international strategies are highlighted in the section below.

11.7.3 Pressures for cost reduction and local responsiveness

According to Hill,⁷⁵ organisations that compete internationally generally face two types of conflicting competitive pressures, namely pressures to be locally responsive and pressures for cost reductions.

Pressures for local responsiveness are found in multidomestic industries and originate from differences in consumer tastes and preferences, infrastructure, distribution channels and host government relations in a foreign country. Of these pressures, differences in consumer preferences that primarily result from cultural differences between countries are by far the most important of the above factors. This requires that, to be competitive, organisations need to adapt, differentiate and customise their products to unique customer preferences and tastes in each of their foreign markets. However, customising products and services for each national country market conceivably results in substantial duplication of activities across national country markets, does generally not allow product standardisation, and leads to higher costs. Such organisations therefore cannot realistically benefit from economies of scale and accordingly do not compete on the basis of low cost and price, but rather on desired differentiated product features. Examples of products and services that typically have to be adapted for local conditions in individual foreign markets are non-durable consumer goods, processed foods and financial services.

The second type of competitive pressure, that for cost reductions, which inherently relates to products in global industries, requires an organisation to reduce costs through mass production of standardised products to benefit from economies of scale. The organisation can only achieve this where products need little or no adaptation to satisfy different foreign market requirements. Under these circumstances, organisations can realise location economies, and increase profitability by readily leveraging core competencies across different global markets. This is particularly the case in industries producing low-cost commodity-type or globally standardised products for price-sensitive buyers. Examples include chemicals and steel, as well as electronic products such as microchips and personal computers.

These two types of competitive pressures clearly place conflicting demands on an organisation. In the sections that follow we indicate how they influence the choice of an organisation's international strategy.

11.7.4 Competitive strategies for international business

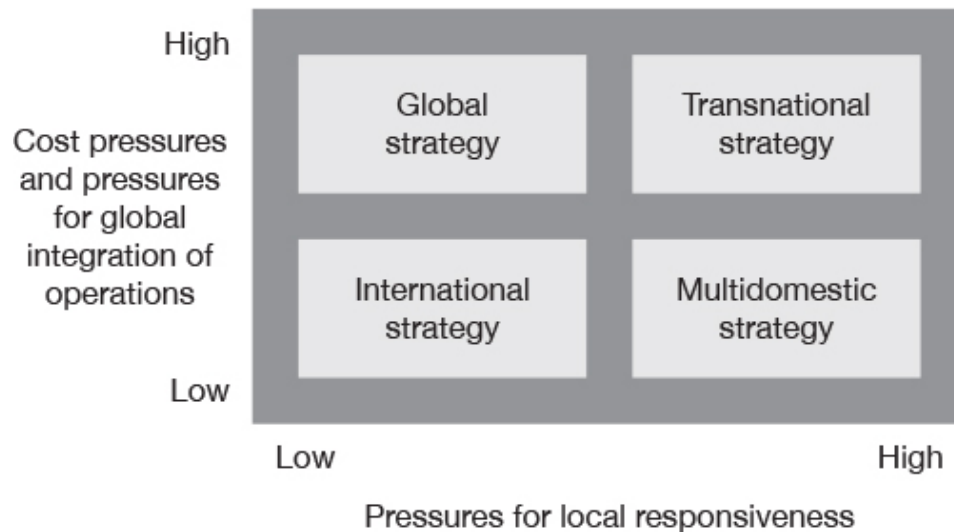
When competing internationally, organisations can use any of the following four strategies:

- International
- Multidomestic or localisation
- Global
- Transnational.

While each of these strategies has its advantages and disadvantages, the question of appropriateness of a strategy depends on an organisation's type of product or service, and whether it is subject to pressures for cost reductions or

local responsiveness in a specific foreign market or markets. The answer to this question, in effect, basically indicates which of the four international strategies will be appropriate in a specific international situation. The appropriateness of each strategy in relation to the two pressures is illustrated in Figure 11.6. We now discuss these strategies, their appropriateness and their importance in international operations.⁷⁶

Figure 11.6 Four international competitive strategies⁷⁷



11.7.4.1 International strategy

An international strategy is appropriate where organisations have valuable core competencies that indigenous competitors in foreign markets lack, and where organisations face relatively weak pressures for both local responsiveness and cost reductions. This is the case with Microsoft worldwide. Organisations pursuing an international strategy therefore generally tend to:

- centralise R&D, product design and product development functions at home
- establish manufacturing and marketing functions over time in each major country in which they are involved
- limit customisation of products for different foreign markets due to weak pressures for local responsiveness
- retain tight head office control over product and marketing strategies.

Competitive advantage and value creation thus come from transferring core competencies and products to markets where these are lacking. Firms intent on exporting from their home country generally adopt this strategy, which does allow economies of scale to be attained. However, when establishing operations abroad, the duplication of manufacturing facilities in various foreign markets over time might not allow economies of scale to be achieved, resulting in higher costs, and making this strategy inappropriate in markets with high pressures for cost reduction. A worldwide product division organisational structure with a predominantly ethnocentric orientation and staffing policy to allow for the effective transfer of core competencies could be appropriate here. This strategy has been successfully deployed by organisations such as Toys'R'Us, IBM, Kelloggs and Microsoft. Products in this category include stationery, packing materials, toys and some domestic appliances.

11.7.4.2 Multidomestic or localisation strategy

Hill states that multidomestic strategies are most appropriate when high pressures for local responsiveness and low pressures for cost reductions exist. Organisations pursuing this strategy accordingly customise their products and marketing strategies from one national market to the next to meet the specific preferences and tastes of consumers

as well as the marketing and distribution requirements in their different foreign markets. Key characteristics of a multidomestic or localisation strategy include the following:

- Customisation or frequent adaptation of products for each separate foreign market is required.
- There are few, if any, system-wide opportunities to realise economies of scale.
- Value-creating and value-adding activities, including production, marketing and R&D, are decentralised by country and duplicated in each national market.
- Competition in each country is essentially independent of competition in other countries, and competitive advantage is inherent in each separate national market.
- Organisational decision-making is decentralised, national subsidiaries function in a largely autonomous manner, and coordination of marketing and sales is localised and takes place in each national market.
- Limited organisational learning and no or minimal leveraging of core competencies across countries occur within the MNE.
- Cost structures are high, and with higher-priced, differentiated and customised products, organisations compete in terms of product features for which consumers are willing to pay, and not on the basis of cost and price.

As a result of decentralised decision-making and distinct, autonomous national markets, a worldwide area structure and a polycentric orientation and staffing policy would be most appropriate for organisations pursuing a multidomestic or localisation strategy. Organisations marketing consumer non-durable products, processed food and financial services typically deploy multidomestic strategies.

11.7.4.3 Global strategy

Hill maintains that a global strategy should be adopted where pressures for cost reduction are strong and demands for local responsiveness are minimal. Global strategies focus on increasing profitability by benefiting from cost reductions obtained from experience curve effects, economies of scale, economies of scope and location economies. Key characteristics of a global strategy include the following:

- Mutually interdependent subsidiaries in the various foreign countries concerned
- Marketing of standardised products worldwide to price-sensitive consumers
- Global economies of scale in key activities
- Leveraging firm technology across many markets
- Global coordination of sales
- Centralised decision-making, control and reporting activities
- Production, marketing and R&D functions concentrated in a few favourable locations.

Organisations using a global strategy require a strong organisational culture to aid system-wide coordination and networking across many markets. A worldwide product division organisational structure and both geocentric and ethnocentric orientations and approaches to staffing are appropriate, with strong coordination and control systems in place. Microchips, personal computers, general consumer electronics, machine tools, jeans and audio equipment as well as commodity-type products like cement, basic steel products and sugar are examples of typical global products that are generally standardised, mass produced, have low switching costs and are sold worldwide.

11.7.4.4 Transnational strategy

Transnational strategies are appropriate where MNEs simultaneously face high pressures for cost reductions and for local responsiveness, and where significant opportunities exist to leverage valuable skills in an MNE's global network of operations. The competitive pressures described here imply that these MNEs have extensive global networked operations where core competencies do not flow only from the parent organisation to subsidiaries, but also from subsidiaries to the parent organisation as well as between foreign subsidiaries. These MNEs benefit from a process of

global learning, and require a strong organisational culture, extremely effective global coordination, and a geocentric orientation and approach to staffing. Key characteristics include the following:

- These organisations establish manufacturing facilities in a few favourable locations to attend to customisation where required. They also pursue low costs by using multipurpose, universal components across countries where possible. Transnational organisations such as Caterpillar and Walmart have successfully achieved this with their global logistics and distribution capabilities, and car manufacturers like Toyota use vehicle production platforms globally, adapting body and other configurations to suit local preferences where necessary.
- Decision-making is both centralised and decentralised. Structures are complex and usually require a matrix organisational structure with a complex dual reporting system.

Organisations such as Caterpillar, Walmart, Unilever and Asea Brown Boveri (ABB) are successfully pursuing transnational strategies, while those such as Nestlé, Anhauser-Busch InBev and Sasol have developed into transnational organisations.

11.7.5 Summary

International expansion requires that an organisation develop appropriate strategies, keeping in mind that it has to contend with two types of pressures, namely for local responsiveness and cost reductions. It is therefore important to note that industry characteristics, the type of product or service, and related consumer needs will largely determine the type of pressure with which an organisation has to contend, and hence the appropriate international strategy to adopt. Having discussed international, multidomestic or localisation, global and transnational strategies and their appropriateness in specific circumstances, we now turn to strategies for foreign market entry. In [section 11.9](#) we explain how these two sets of strategies, *inter alia*, are integrated into a global strategic management process.

11.8 Strategies for entering foreign markets

Having decided on an appropriate strategy for international expansion, management has to consider the following important questions when deciding on how to enter foreign markets:

- Which markets to enter: This question requires extensive international country and market research
- When to enter the selected markets: The question of timing
- On what scale to enter: Envisaged foreign market scope, dependent on the extent of an organisation's resource availability, readiness and commitments for international expansion
- How to enter the selected markets: Which mode of foreign market entry.⁷⁸

The first three issues require extensive country, industry and market research, including in-depth analysis of potential benefits and risks as a basis for strategic planning and resource allocation. However, the fourth issue regarding the best way for the organisation to enter foreign markets requires extensive knowledge of international business strategy in general, and [foreign market entry modes](#) in particular.

11.8.1 Foreign market entry modes

The following entry modes as illustrated in [Figure 11.7](#) are available to organisations expanding internationally:

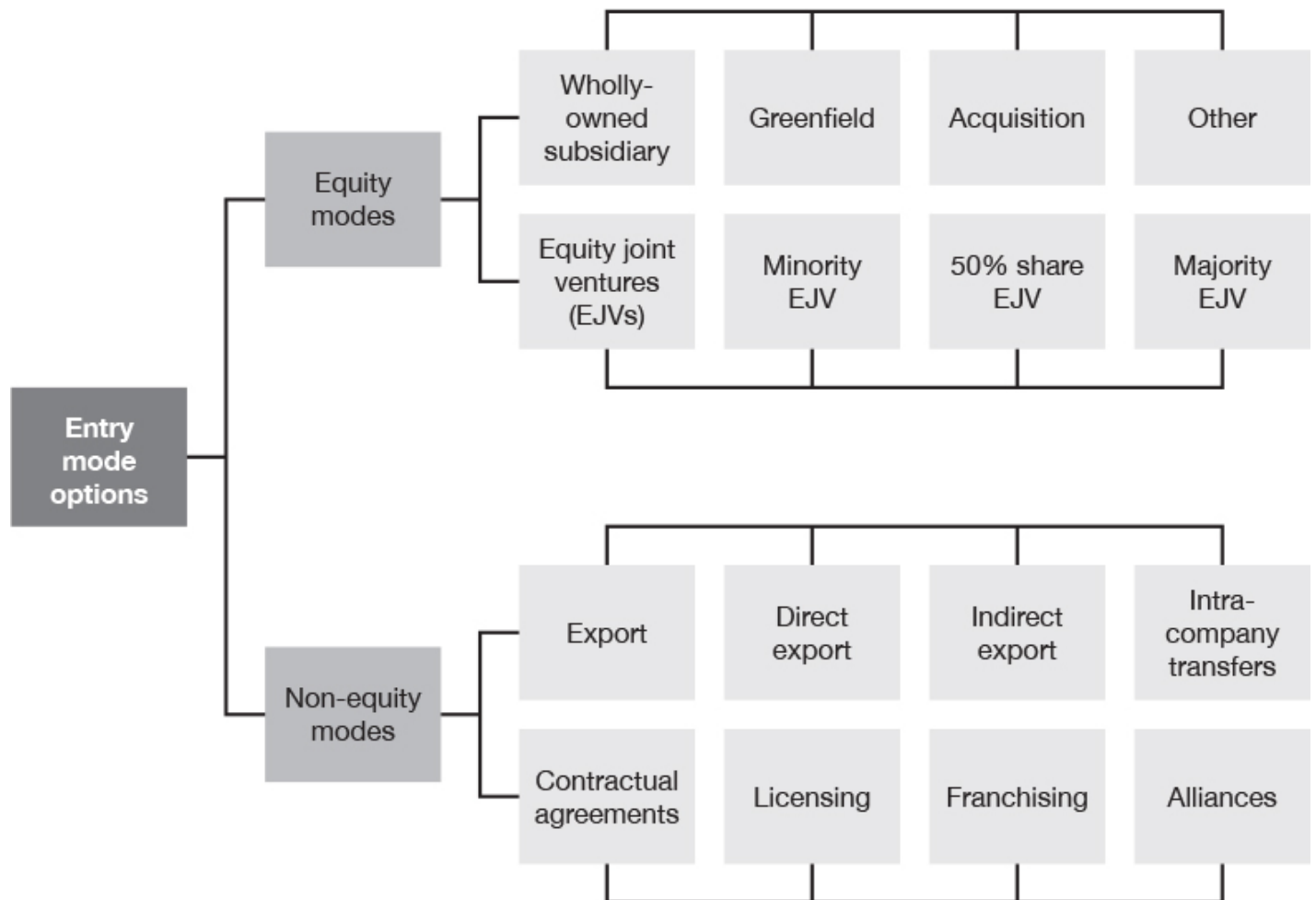
- Exporting
- Licensing
- Strategic alliances, which include short- to longer-term contractual agreements.
- Joint ventures

- Franchising
- Wholly-owned subsidiaries in one or more foreign countries (an equity-based mode of entry).

While not included in Figure 11.7, international turnkey projects are also regarded as a mode of foreign market entry, as explained below. Furthermore, foreign market entry modes are generally classified into equity- and non-equity-based modes, as shown in Figure 11.7. An equity mode is a mode of entry that involves taking full or partial ownership and control in a foreign firm, where full ownership constitutes a wholly-owned subsidiary, and partial ownership a joint venture in a foreign country. In contrast, non-equity modes of entry are based on contractual arrangements between two or more organisations and do not involve owning equity in a foreign firm.

We now discuss the above-mentioned market entry modes, and their unique advantages, disadvantages and risks.

Figure 11.7 A hierarchical model of foreign market entry modes⁷⁹



11.8.1.1 Exporting

Exporting is a non-equity entry mode. Manufacturing firms in particular often begin their international expansion by exporting and only later switching to another more appropriate entry mode. Exporting can be indirect, direct or involve international intra-firm transfers or trade. In indirect exporting, the organisation is in the hands of a domestic export agent and has little control over the process. With direct exporting, the organisation is in control of the exporting process, and gains exporting experience through this involvement. However, the organisation has little

or no control over what happens in the foreign market. International intra-firm transfers or trade involves trade between two subsidiaries in two countries controlled by the same MNE.

Advantages of exporting include the potential to realise economies of scale at home as a result of a larger potential market, and avoiding the cost of setting up manufacturing facilities in another country. Increased production in the home country typically results in higher domestic employment, and export sales generate valuable foreign exchange. Disadvantages may include high transportation costs, trade barriers to imports in the foreign country, and problems with foreign marketing agents. Overall, exporting is a low-risk market entry mode with little or no capital requirements.

11.8.1.2 Licensing

Licensing is a non-equity contractual arrangement. In a licensing agreement, a licensor grants the rights to intangible property to a licensee (foreign licensed organisation). The main advantages of licensing are that the licensee pays a licence fee or royalty to the licensor, and bears all the costs and risks of setting up foreign markets. Also, no capital investment by the licensor in facilities or operations is required. Disadvantages are that the licensor has no control over the licensee to promote and market its products, that global coordination of activities is difficult, and that there is a risk of losing technological knowhow to the licensee, thus creating a potential future rival. An example of licensing in an international context includes the pharmaceutical company Aspen who obtained the exclusive rights for nutritional products from Nestlé for the South African market.

11.8.1.3 Turnkey projects

Turnkey projects are non-equity contractual agreements generally found in engineering and processing industries. The advantages are that they allow organisations to export their knowhow profitably to countries that may restrict FDI. Turnkey projects are less risky than conventional FDI, especially in politically unstable countries. Disadvantages are that turnkey projects are of limited duration with no permanent market presence, and the organisation may create a future competitor. The construction of oil refineries, hydroelectric schemes, airports and harbours are typical examples of turnkey projects.

11.8.1.4 Strategic alliances and joint ventures

In many countries, political considerations make strategic alliances and joint ventures the only feasible mode of market entry.

Strategic alliances are non-equity collaborative agreements between two organisations working towards some common purpose. They are often in the same industry, but not necessarily in the same country. Advantages of strategic alliances are that they allow organisations to benefit from a local partner's knowledge of country conditions, and that they allow alliance partners to share risks and costs associated with research and development, including new product development. Major disadvantages are that organisations may:

- Relinquish control over their technology and intellectual property
- Have insufficient control over their subsidiaries that operate under alliance agreements
- Have incompatible management styles, organisational cultures and control systems that could lead to conflict.

The international commercial airline industry is characterised by numerous successful alliances worldwide. The strategic alliance between KLM and Northwest Airlines was one of the pioneering ventures in this field, and the alliance between Comair and British Airways in South Africa is highly successful. South African Airways (SAA) is one of 28 members of Star Alliance.

Joint ventures differ from strategic alliances in several respects, as shown in [Figure 11.7](#). A joint venture is an equity mode of entry and involves establishing an entirely new legal entity that is jointly owned by two or more partners. This is referred to as an equity joint venture (EJV), whereas strategic alliances, as previously stated, are

based on collaborative contractual agreements. The advantages and disadvantages of EJV's are similar to those of strategic alliances, except that a joint venture implies a permanent arrangement with equity holdings (partial ownership) by all joint venture partners. With reference to [Figure 11.7](#), a 'minority equity joint venture' means that a partner has less than a 50% ownership share in the joint venture, an 'equal share equity joint venture' means that partners each have a 50% ownership share, and a 'majority equity joint venture' means an ownership share of more than 50% up to and including 99%. As in strategic alliances, conflicts may arise from incompatible leadership styles and cultures, and insufficient clarity on long-term goals and objectives. Mutual trust between strategic alliance partners as well as between joint venture partners is generally acknowledged as a critical requirement for success. In both strategic alliances and joint ventures, it is difficult to coordinate diverse global operations.

11.8.1.5 Franchising

Franchising, a non-equity mode, is somewhat similar to licensing. The main advantages of franchising include low development costs, and the fact that the franchisee bears the costs and risks of opening up a foreign market. Disadvantages of franchising for the franchisor include the maintenance of standards and quality control of distant, foreign franchise operations, and that global strategic coordination is often difficult. Well-known franchise operations include McDonald's, KFC and Starbucks, while South Africa's Nando's has been successful in expanding its franchise to numerous foreign markets, including the UK and Australia.

11.8.1.6 Wholly-owned subsidiaries

As an equity mode of entry, a wholly-owned subsidiary, whether established by means of an acquisition or a greenfield venture, means that the organisation owns 100% of the shares. Wholly-owned subsidiaries in foreign markets involve FDI and can be established in two ways:

- An organisation can set up a new venture, generally referred to as a greenfield venture
- It can acquire or take over an established organisation in the foreign country, also referred to as a brownfield venture.

It is assumed that the parent company would have done extensive country attractiveness and market research prior to the decision to establish a foreign subsidiary, whether a greenfield or a brownfield venture.

A greenfield venture occurs where an MNE decides to establish a new subsidiary in a foreign country, developing it from the ground up as opposed to merging with or acquiring an existing firm in the foreign country. The main advantage of a greenfield venture is that the subsidiary can be constructed in total accordance with the company's requirements and expectations. Major challenges for a greenfield venture are that it still has to develop a market in a competitive foreign business environment, decide on a staffing strategy, identify suppliers and establish a viable distribution strategy, to name but a few. It could also take a long time before a profit is realised.

An example of an acquisition is where the international Mittal Group acquired the South African steel producer Iscor to form Ispat Iscor, subsequently renamed Mittal Steel, and more recently Kumba Resources, rather than establishing a new steel-producing operation in South Africa.

The main advantages of wholly-owned subsidiaries as a mode of foreign market entry include the following:

- The MNE retains effective control over its core capabilities, especially in high-technology industries.
- The MNE has a means of effective control over its operations in various countries, which simplifies global strategic coordination.
- Taking over a current business generally implies having an established market to exploit further.
- An acquisition basically eliminates a competitor when acquiring or taking over a foreign firm.
- It is possible for the MNE to locate its subsidiaries in the most cost-effective countries or regions.

Disadvantages of wholly-owned subsidiaries include the following:

- It is the most costly way of entering foreign markets as it requires huge amounts of capital.

- The risk of loss is significant, especially for greenfield ventures in unproven markets.
- When acquiring established foreign organisations, the merging of different cultures, structures and systems could give rise to further problems.

11.8.2 Selecting an optimal foreign market entry mode

Organisations considering international involvement should carefully weigh the benefits, costs and risks of each entry mode. However, the following broad guidelines could be considered:

- If an organisation's competitive advantage is predominantly in technological knowhow, licensing and strategic alliances may not be appropriate, and a wholly-owned subsidiary could be preferable.
- When an organisation's competitive advantage resides in managerial knowhow, for example McDonald's or Nando's, franchises or joint ventures may be preferred to licensing and wholly-owned subsidiaries.
- When deciding to enter politically unstable markets, strategic alliances or joint ventures could provide some assurance due to the involvement of local partners.

11.8.3 Summary

In this section we explored the strategic importance of the various modes of foreign market entry in terms of their characteristics, advantages and disadvantages, as well as their appropriateness in a variety of international business situations.

11.9 International strategic management in a global context

In the previous sections, we identified the generally accepted international strategies and market entry modes available to organisations involved in or considering international business involvement. Here we develop a framework for strategic management in a global business context.

11.9.1 Developing an international strategic management framework

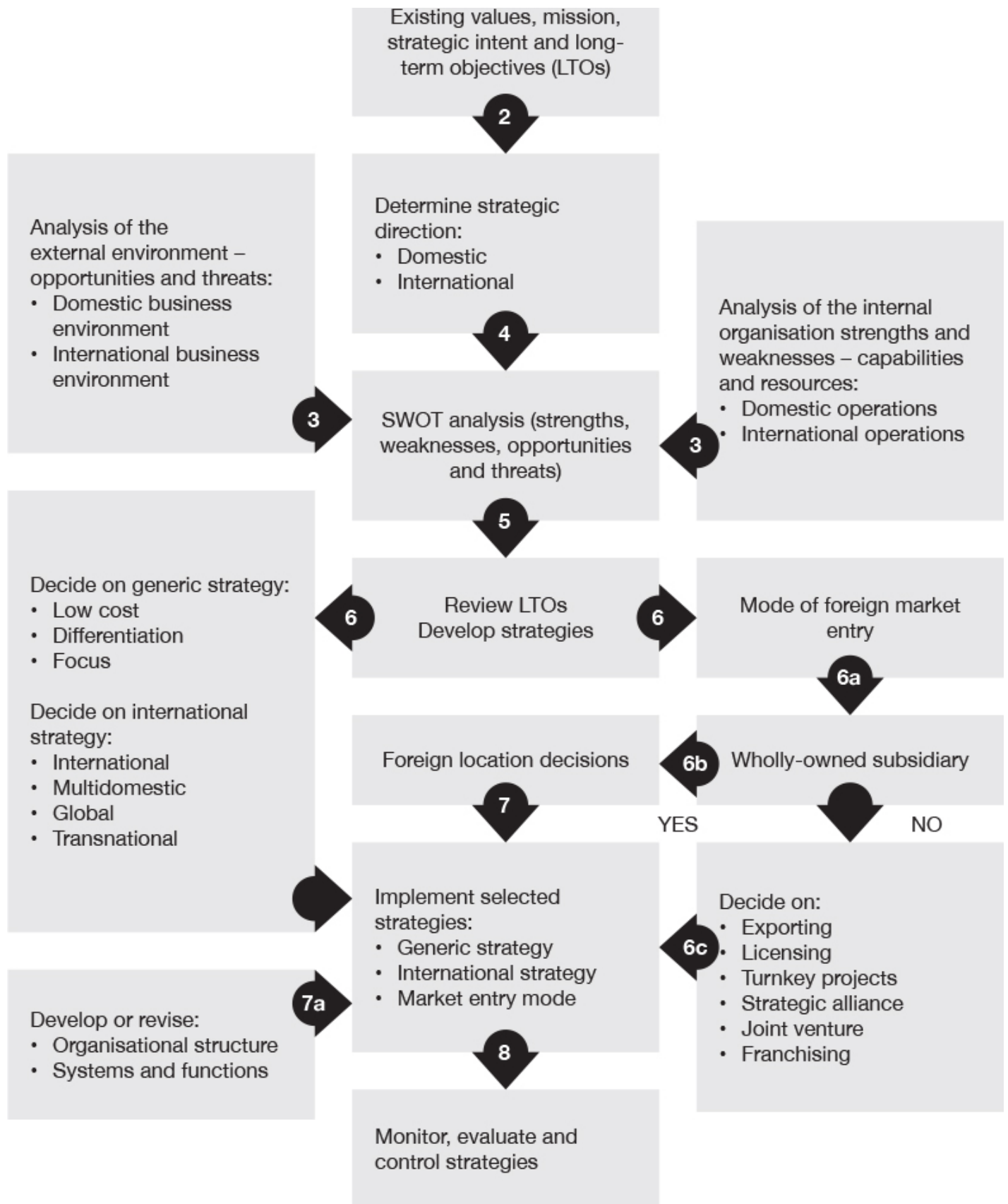
The three main phases of a generic strategic management process – strategy formulation, strategy implementation and strategy evaluation and control, as outlined in [Chapter 1](#) – apply to both domestic and international organisations. However, as we have seen, international involvement significantly adds to the complexity of the strategic management process and the demands on management. With the process illustrated in [Chapter 1](#) (see [Figure 1.6](#) as our point of departure, we now outline the **international strategic management process** with reference to [Figure 11.8](#), which clearly indicates the added complexity resulting from international involvement.⁸⁰

The various phases in [Figure 11.8](#) are numbered to reflect the sequential decision-making steps in the process that has evolved from both the theory and practice of international management and strategy in recent decades. These steps are as follows:

- *Step 1:* Evaluate the current profile of the MNE in terms of its vision, mission, strategic intent, long-term objectives (LTOs), organisational culture and values as a point of departure for global strategic planning. However, long-term objectives are typically finalised only after analysis of the organisation's external and internal environments and SWOT analysis (see step 4 below)

Figure 11.8 The international strategic management process⁸¹





- *Step 2:* Align the strategic assumptions on which the current business strategy (domestic and/or international) is based with the envisaged international involvement or expansion. This phase also includes alignment of the vision, mission and long-term objectives of the organisation.
- *Step 3:* Analyse the domestic and global external environments as well as the organisation's internal environment.
 - » Scanning the external environment involves identifying important and relevant political, legal, economic, sociocultural, technological, demographic and natural environment forces in both the domestic and international business environments as potential opportunities or threats. In international strategic management, external environmental scanning is also the starting point for the analysis of country attractiveness, country risk and foreign market potential, all of which have little or no relevance to domestic operations.
 - » Analyse the internal environment of the MNE in terms of strengths and weaknesses in its value chain to identify its internal competitive advantage related to its capabilities and resources, and to assess its readiness for internationalisation, also taking into account the home country's national competitive advantage as related to the industry key success factors.
- *Step 4:* Conduct a SWOT analysis on the outcomes of the external and internal analyses to identify the impact that potential opportunities, threats, strengths or weaknesses may have on the achievement of the organisation's envisaged domestic and international strategic objectives. It is important that the outcomes of the SWOT analysis, in turn, serve to realign and finalise the vision, mission and long-term objectives of the organisation.
- *Steps 5 and 6:* Strategy formulation and choice of strategy here are much more complex than for a domestic organisation as three distinct strategic decisions have to be considered. These involve deciding on:
 - » the appropriate generic strategy for domestic operations should any change of the existing strategy be required (low cost, differentiation or focus)
 - » the appropriate international strategy (international, multidomestic (localisation), global or transnational)
 - » the mode of foreign market entry (exporting, licensing, turnkey project, forming a strategic alliance or joint venture, franchising or establishing a wholly-owned subsidiary in a foreign country).
- Based on revised long-term objectives, the strategy formulation in Step 5 thus involves the decisions in Steps 6, 6a, 6b and 6c, as outlined above. With regard to mode of entry, if the organisation decides on a wholly-owned subsidiary, it must make an additional decision with regard to the countries in which to locate the organisation's subsidiaries, as in Step 6b. The choice of appropriate generic and international strategies will depend largely on the industry characteristics, the MNE's products or services, and the extent of pressures for cost reductions or local responsiveness. To benefit from economies of scale, most organisations rely initially on marketing their existing products or services internationally through exporting.
- *Steps 7 and 7a:* Implementing the three distinct types of strategies is considerably more complex than strategy implementation domestically. Country differences (political, legal, economic, sociocultural, technological, demographic, physical and natural environments) and geographic distance are complicating factors in this regard. Revision and/or adaptation of organisational structures, systems and procedures, including reporting procedures in Step 7a are required to facilitate strategy implementation. Marketing, financing, staffing and operations as well as information systems typically need review and adaptation to the international dimension.
- *Step 8:* Once implemented, ongoing monitoring, evaluation and control of both the domestic and the international strategic processes are required to ensure satisfactory performance.

International organisations will obviously have to adapt the above strategic management framework to their own unique situations, which could include aspects such as the extent to which the parent organisation is diversified across industries, and how many foreign markets it wants to enter.

STRATEGY IN ACTION: Mahindra plans assembly in South Africa⁸²



The economic downturn on the African continent, fuelled by a steep decline in commodities, has seen new vehicle sales in Africa drop from a peak of 1.72 million vehicles in 2014 to 1.2 million vehicles in 2017. However, while the continent's motorisation rate of 42 vehicles per 1 000 people compared to the global average of 180 vehicles per 1 000 people remains the lowest of any region in the world, it does signal the significant potential for the continent's automotive market to grow. Although South Africa manufactured 601 178 units or 56.4% of Africa's vehicle production in 2017, the industry was ranked 22nd with a global market share of 0.62%, remaining relatively small in global terms.

However, South Africa's automotive manufacturing sector contributed 6.9% to South Africa's GDP in 2017, down from 7.4% in 2016, and total South African export earnings reached R164.9 billion in 2017, comprising 13.9% of South Africa's total export earnings, although lower than the R171.1 billion in 2016 that represented 15.6% of total export earnings in that year. On the other hand, the value of vehicle imports into South Africa increased from R56.2 billion in 2016 to R59.8 billion in 2017. India, at 88 110 units or 19.9% of total light vehicles imported, was the top country of origin in volume terms in 2017. Given its export achievement, Indian vehicle manufacturer Mahindra, in its 14th year of business in South Africa, in early May 2018 was set to announce details about its plans to assemble its vehicles in South Africa. The Mahindra Group is a diversified multinational company headquartered in Mumbai, India, with operations on over 100 countries around the world. Newly appointed chief executive Rajesh Gupta said the company would start with the assembly of the Mahindra Pik-Up. 'This will offer us a sound footing on which to further entrench our South African sales success,' he said. The assembly would be supported by the expansion of Mahindra's products and services. Mahindra South Africa has not yet disclosed where its assembly plant will be located. There has been speculation over the past few years that Mahindra would assemble one or more of its models in the planned new greenfield multi-model vehicle manufacturing plant in the East London industrial development zone that was to be operated by an outsourced assembler. However, industry sources have indicated the pick-up will be assembled in Durban. At this time chief financial officer Avinash Bapat said Mahindra was gearing up for a new phase of growth and expansion in South Africa. 'Measured in terms of our sales over the past five years and removing smaller brands with annual sales of less than 1 000 units, Mahindra is one of the five fastest growing brands in South Africa,' he said. Mahindra, a dominant manufacturer of sport utility vehicles and pick-ups in India, achieved year-on-year growth of 12.7% in its financial year to March 2018, representing a compound annual growth rate of 19% over the past two years.

Questions

1. In your view, why would Mahindra consider investing in an automotive assembly plant in South Africa if they seem to have been relatively successful in exporting their vehicles from India to South Africa over the past 14 years or so?
2. What are the advantages that South Africa inherently holds for Mahindra regarding this investment? What are possible drawbacks that South Africa holds in this regard?
3. Why does Mahindra prefer establishing a wholly-owned subsidiary through foreign direct investment rather than a joint venture with a local South African vehicle manufacturing company?
4. Evaluate the attractiveness of the South African light-vehicle manufacturing industry in terms of Porter's five forces model of industry competitiveness (presented in [Chapter 6](#)). Based on your evaluation, what are the prospects of this initiative for Mahindra?

11.9.2 Summary

Although much the same fundamental strategic management logic, processes and frameworks apply to both domestic and international business operations, there are distinct differences in content and context, as well as in a number of important decision-making steps, capturing the relatively greater complexity of international strategic management in a global context.

11.10 Summary

Given the increasing trend in the globalisation and internationalisation of economic and business activity in recent decades, expanding internationally has become imperative in many industries. Organisations need to develop viable international competitive strategies to internationalise in an increasingly competitive global environment. In the context of a rapidly changing global business environment, this chapter explored the motives for international expansion, the sources of competitive advantage for such expansion, and the relevant international competitive strategies that organisations can pursue to enter and compete in foreign markets. Essentially, this chapter focused on extending strategic thinking, planning and management to the global business environment.

Because countries differ in terms of their political, legal, economic, sociocultural, technological, and demographic environments, it was shown that international business differs profoundly from, and is considerably more complex than, domestic business, posing extreme challenges to management and leadership. The approach in this chapter was to explain why international business is different, why both the organisation and the environment are sources of competitive advantage, how to develop international strategies to cope with various industry and environmental forces in foreign markets, and how to enter foreign markets within a framework of integrated international strategic management.

REFLECTION BOX:

How would you view envisaged major global changes in the technological environment related to the following industries?

1. The transportation industry, from an individual as well as a commercial perspective, given the recent advent of electric self-driving cars and commercial vehicles as well as air taxis. What other industries might be affected by such developments? How might such developments impact the strategies of companies involved in the traditional vehicle manufacturing industry?
2. The renewable energy industry, from the perspective of an entrepreneurial firm envisaging entering this industry with a view to expanding internationally over time. What could the major challenges be for such a venture, also given the generally accepted motives for internationalisation?

Opening case study questions

1. As the largest and extremely competitive South African commercial bank already operating in some 20, mostly Anglophone, countries throughout Africa, the case provides very little macroenvironmental information about Côte d'Ivoire in support of Standard Bank's decision to establish itself in that country. Conduct a PESTEL analysis of Côte d'Ivoire (evaluation of political, economic, sociocultural, technological, ecological and legal macroenvironmental factors) to assess the attractiveness of the country for a financial services company like Standard Bank.
2. Despite Standard Bank's experience in almost exclusively Anglophone countries thus far, could it merely 'transplant' its existing strategies that worked in South Africa and these other Anglophone African countries to a Francophone country? Why or why not?
3. If you were requested to advise the management of Standard Bank about analysing Côte d'Ivoire's political risk, what approach to analysing this would you recommend? Explain your recommended approach fully.

Discussion questions

1. Discuss and compare the advantages and disadvantages of the four international competitive strategies. Explain which of these strategies will be most appropriate for international organisations producing the following products and why:
 - a) Cement
 - b) Computer keyboards
 - c) Instant coffee
 - d) Motor vehicle batteries.
2. Analyse and define the concept of competitive advantage. How would the competitive advantage of a domestic organisation typically differ from that of an organisation involved in international business? What are the reasons for this difference? Is the knowledge that such a difference exists of importance to an international manager? Why or why not?
3. Discuss and evaluate Porter's diamond of national competitive advantage. Of what value is Porter's approach in this regard for an international manager? Explain and substantiate your views.

Using knowledge and skills

1. Your South African-based organisation, involved in manufacturing sophisticated world-class medical equipment, plans to market a technologically advanced, high-value laser-optic device for use in surgery in the EU where a demand for this product has already been established. The CEO of your company has requested you to make recommendations with regard to the following:
 - a) The choice of a suitable EU member country, based on macroenvironmental political, economic, legal, cultural, demographic and technological considerations, noting that a free trade agreement exists between the EU and South Africa. Use various sources, including the internet, to answer this questions.
 - b) The appropriate international strategy to be deployed in this case
 - c) The appropriate mode of foreign market entry that should be considered.Write a three- to four-page report on your findings, motivating your recommendations on each of the above aspects. (It may be useful to review [Chapters 4, 5 and 6](#) in this regard.)
2. Identify a South African organisation involved in international business with which you are familiar or from which you can obtain information. Given the organisation's industry profile and standing, as well as its product and/or service profile, write a brief report that outlines and substantiates the following:
 - a) The industry characteristics (Porter's five forces analysis)
 - b) The perceived strategy or strategies pursued by the organisation (which of the four 'international' strategies)
 - c) The mode or modes of foreign market entry that the organisation adopted.Conclude your report by briefly commenting on the future strategic expectations of the organisation. (It may be useful to review [Chapters 4, 5 and 6](#) in this regard.)

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Suggested websites

- Department of Trade and Industry (<http://www.thedti.gov.za>) – For information relating to South Africa's exports and FDI programmes
- Europa (europa.eu/index_en.htm) – The official website of the European Union
- Financial Times* (<http://www.ft.com>) – One of the world's leading business news organisations, and recognised internationally for its authority, integrity and accuracy
- The Economist* (<http://www.economist.com>) – The leading source of analysis on international business and world affairs
- The World Bank (<http://www.worldbank.org>) – Working for a world free of poverty

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PART FOUR

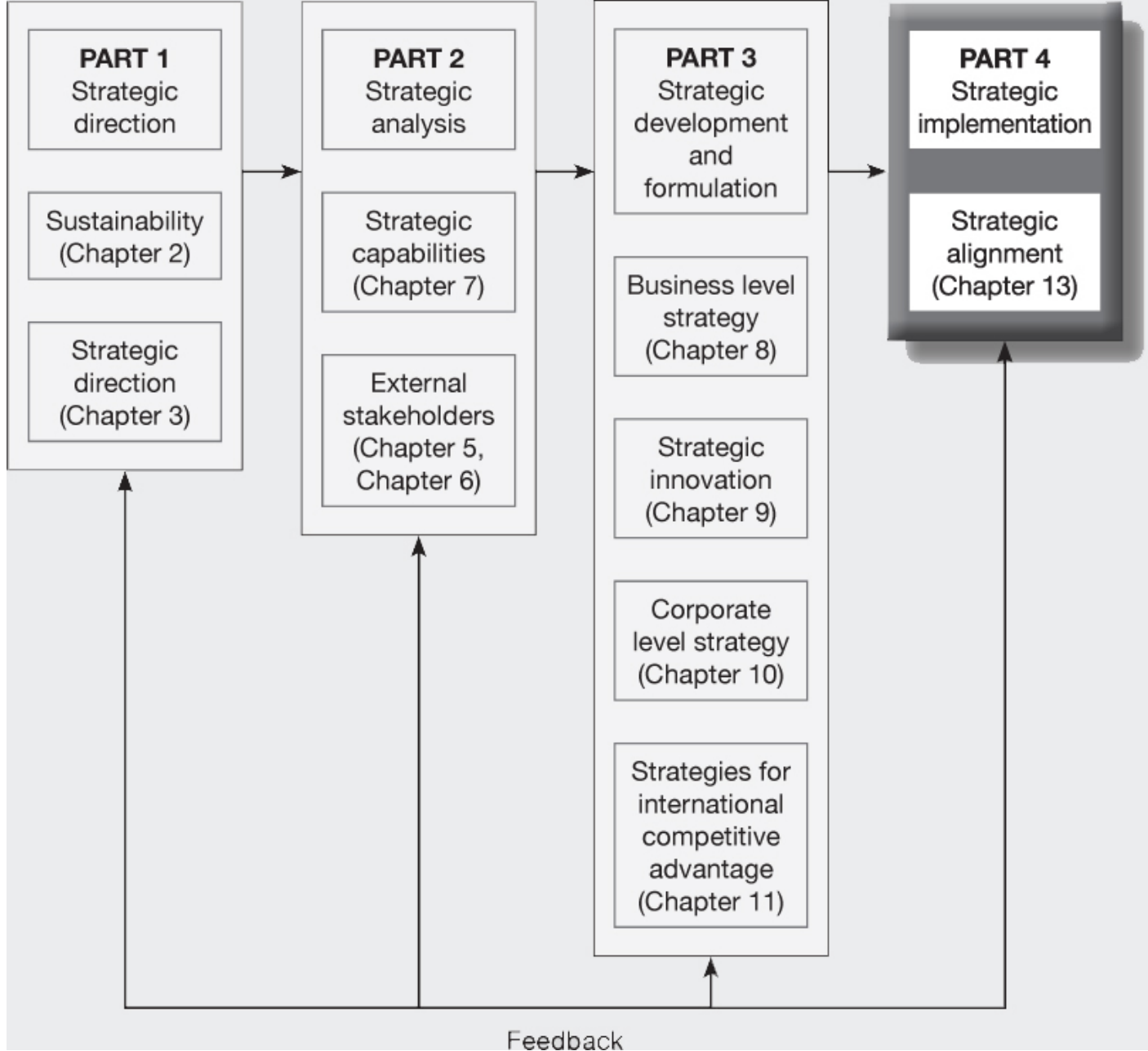
Strategic implementation

THE ORGANISATION'S STRATEGIC CONTEXT

Strategic
decision-
making
(Chapter 4)

Strategic leadership
(Chapter 12)

Strategic risk management
(Chapter 14)



CHAPTER 12

Strategic leadership

Trevor Amos

LEARNING OUTCOMES

After reading this chapter, you should be able to:

- explain the responsibility and role of top management in strategy implementation
- explain what is meant by the term 'strategic leadership'
- advise on the value of strategic leadership in successful strategy implementation
- identify and explain the key responsibilities of strategic leadership.

KEY TERMS

core competencies
corporate governance
[emotional intelligence](#)
[leaders](#)
[leadership](#)
[organisational culture](#)
[organisational climate](#)
[strategic leadership](#)
strategic thinking
strategy implementation
[ubuntu](#)

OPENING CASE STUDY



Strategic leadership in action at AutoTrader

[Chapter 1](#) introduced the case of AutoTrader where the CEO, George Mienie, and his management team successfully transformed the business from a print company to a disruptive tech and digital business positioned 'for growth in the digital market of buying and selling cars.'¹ The entire trajectory and revenue model of the

business was changed. Currently, 'AutoTrader.co.za's online customer base is exponentially greater than the size of its print readership at its height'.²

The forward thinking of the CEO and his management team, and their willingness to disrupt their own business model, together with their ability to implement their thinking, made the difference to AutoTrader, providing an example of strategic leadership in action.

It all started with looking into the future and thinking that '... even though South Africa wasn't quite ready for the internet in 2007, there would come a time when it would be, and AutoTrader could either have a market solution that was an industry leader, or be one more business behind the innovation curve and entering permanent stasis'. However, 'successful disruption doesn't lie in recognising you need to be disruptive, or even coming up with bold, innovative ideas — it's all about execution,' insists George. 'I get bored in a room full of "ideas people". The world is full of great ideas and idea people. But successful execution is extremely rare and it accounts for nine tenths of success. You can't stay ahead of the curve without being an innovative organisation, and that all comes down to how well you execute your ideas.'

'It's an ongoing process. The moment you stand still, you become a template for others to follow. We are copied all the time, we change something, and competitors follow suit. You grow, plateau, decline; that's the innovation S-curve that business courses love to discuss. But innovators understand that when one S is declining, another is conjoined and on the upward swing. The trick is to recognise when you're going to plateau so that you're already planning for your next business model shift. There's a lull between the two. I call it the valley of tears. It's painful. It requires serious change, and if you stay there your business is in trouble — but it also gives you the gift of time to re-engineer the business.'

Because execution is so important, the processes and team supporting innovation, and particularly business model adjustments, are crucial. 'Balanced scorecards play a big role for us,' says George. 'When we began this process, top management had a vision that needed to be executed by the whole team. The balanced scorecard was our link, our sounding board for execution. It takes a lot of work. You have to break up what you want to do into little parts to ensure people and activities are all working together. It's particularly challenging breaking old, established silos apart, but we managed to do it. The whole organisation is open plan. Different departments are encouraged to work and socialise together, ensuring no silos are created, and information and advice is shared freely.'

Innovation is not a once-off activity. It is a process that needs to become entrenched in the organisation. Integral to this is the constant re-evaluation of what the business has that adds value to its customers. 'The business needs to view change as a constant, not just as a concept, but something deeply entrenched in our people's DNA,' explains George.³

Overview

Once an organisation has selected and developed its strategies, it then has to implement them, which is the responsibility of top management. To successfully do so, top management needs to fulfill the role of strategic leadership, which consists of a number of key responsibilities. These are the specific tasks and duties that top managers need to fulfill as a function of their role as strategic leaders.

The chapter begins with identifying the need and value of strategic leadership in an organisation, and outlines what is meant by strategic leadership. The key responsibilities of strategic leadership are then identified and explained.

Strategic leaders need first to **understand organisations** as a whole, which **requires strategic thinking**.

They need to **lead organisations** effectively and ethically for strategic results. Effective ethical leaders are individuals who have a clear sense of right and wrong, respect human dignity and rights, and are results driven. They are **emotionally intelligent** with a range of behaviours or **leadership styles** at their disposal to apply wisely in order to influence people and achieve results constructively. In applying leadership styles, they acknowledge that the feasibility of these styles depends on the **cultural conditioning** of subordinates.

A compelling **vision** need to be developed and communicated by strategic leaders

Strategic leaders create an **integrated organisational system** aligned with the strategy to enable implementation. Creating this requires that strategic leaders understand the organisation as a whole, and design and

implement appropriate organisational **structures** and relevant enabling systems, processes and policy; **staff** the organisation with talented people and ensure their behaviour is aligned to the requirements of strategy; ensure appropriate **leadership** within the organisation; create organisational **culture**; and set **climate**.

Strategic leaders also need to:

- build on existing or develop new distinctive organisational **capabilities**,
- ensure **ethical practices and good governance**, and
- initiate and lead strategic **change**, ensuring the allocation of resources to key strategic change initiatives.

Successfully engaging in the key responsibilities enables top management to lead strategically for successful strategy implementation.

12.1 Introduction

The formulation and choice of a strategy is important, but unless there is a conscious and active effort to implement the chosen strategy across the organisation. The strategy is of little value if the ability of the organisation to adapt and survive is threatened. As David Kneale, CEO of Clicks Group Limited, said, 'success is 10% strategy and 90% execution'.⁴ For organisations to succeed and be sustainable, strategy clearly needs to be successfully implemented.

Although 'all managers become strategy-implementers in their areas of authority and responsibility, and all employees are participants',⁵ top management is ultimately responsible for the successful implementation of strategy. This means that top management has the task of creating a true whole that is larger than the sum of its parts, a productive entity that turns out more than the sum of the resources put into it. One analogy is the conductor of a symphony orchestra. The instrumental parts are limited. But the conductor has the composer's score; he is only the interpreter. The manager is both composer and conductor. This task requires the manager to bring and make whatever strength there is in their resources – and above all in the human resources – and neutralise whatever weaknesses there are. The task of creating the genuine whole also requires that the manager simultaneously considers the performance and results of the enterprise as a whole and the diverse activities needed to achieve a synchronised performance. The second specific task of the manager is to harmonise, in every decision and action, the requirements of both the immediate and the long-term future.⁶

A key factor in successfully implementing strategy is strategic leadership. In fact, 'a lack of leadership, and specifically strategic leadership, at the top of the organisation has been identified as one of the major barriers to effective strategy implementation'.⁷ Without effective strategic leadership, 'the probability that a firm can achieve superior or even satisfactory performance ... will be greatly reduced'.⁸

Strategic leadership is about the leadership of entire organisations by top-level executives, as compared to leadership in organisations, which is the responsibility of all other managers at the middle and lower levels, and which focuses on operational or tactical aspects of leadership.

Strategic leadership is the ability of a person to anticipate, envision, maintain flexibility and think strategically.⁹ It is also the ability to influence and work with others to make day-to-day decisions and to initiate changes that will create a viable future for the organisation and enhance its long-term viability while maintaining its short-term stability.^{10, 11} Strategic leadership is the ability to:

- understand an organisation as a whole with its various interrelated components in its broader, changing and volatile environment and industry, including stakeholders;
- envision a viable future for the organisation and the path or strategy to that future;
- work with and through people and other resources to lead movement towards its future; and
- recognise the current reality of the internal environment of the organisation and, where necessary, initiate and manage necessary strategic change to position the internal environment of the organisation as an integrated

system, ensuring it is enabled to implement strategy both for short-term stability and long-term performance and sustainability.

As illustrated in the Opening case study, the forward-thinking CEO George Mienie and his management team, together with their ability to implement their thinking made the difference, and provides an example of strategic leadership in action. When thinking of strategic leaders, a few iconic names come to mind.¹² Sol Kerzner conceived an idea and realised his dream in the form of the Sun City resort and other top luxury hotels in South Africa and worldwide. The late Pam Golding founded Pam Golding Properties and grew it into one of the biggest real estate property groups in the country. Adrian Gore founded Discovery Health, an organisation that changed health insurance with innovative products such as its Vitality programme. Another example of a strategic leader who thinks big and dreams even bigger is South African-born Elon Musk, who is revolutionising transportation by bringing fully electric vehicles to the mass market: '[H]e only wants to solve bigger, worldly problems like the existence of humanity – create sustainable energy, provide clean transportation, and discover interplanetary space travel. His track record includes founding ... SpaceX to discover interplanetary co-existence; Tesla [to transform] sustainable energy for humanity, and [co-founding] Paypal, which revolutionised online payment.'¹³ All of these individuals are strategic leaders.

The chapter now moves on to identify and outline seven key responsibilities of strategic leaders:

- Understand the organisation as a whole
- Lead effectively and ethically for strategic results
- Develop and communicate a compelling vision to lead change
- Create an integrated organisational system to enable the implementation of the strategy
- Build and use distinctive organisational capabilities aligned to the strategy
- Ensure ethical practices and good governance
- Initiate and manage strategic change.

12.2 Understand the organisation as a whole

A key responsibility is for strategic leaders to understand the organisation as a whole. This responsibility:

*... involves the ability to see the enterprise as a whole; it includes recognizing how the various functions of the organisation depend on one another, and how changes in any one part affect all the others; and it extends to visualising the relationship of the individual business to the industry, the community, and the political, social, and economic forces of the nation as a whole. Recognising these relationships and perceiving the significant elements in any situation, the manager [sic] should then be able to act in a way which advances the over-all welfare of the total organisation.*¹⁴

This is strategic thinking and 'of all the components inherent in leading an organisation in developing and implementing a strategic planning process, none is more important than the capacity for strategic thinking and creative thinking'.¹⁵ In fact, 'organisational failure throughout the global business world is replete with examples of how the lack of strategic and creative thinking were among the root causes of many of these failures'.¹⁶

12.2.1 Strategic thinking

Strategic thinking is the mental process of reasoning applied by an individual to achieve success in any task. Think of the reasoning applied when your car suddenly loses power and you pull over and open the bonnet. You stand looking over the engine observing the reality of the situation. You identify that the coolant level is below minimum.

You diagnose the situation to understand it better. Your diagnosis reveals that there is coolant dripping from under the car and that it is coming from the bottom of the radiator. You wonder what to do ... you consider a few options but decide that the solution is to seek expert advice. You implement this solution by checking the directory on your phone and calling the dealership to explain the problem. Strategic thinking requires that one identifies the reality of the situation, and diagnoses it in order to define and understand it better. On the basis of this diagnosis, one then generates and implements solutions to create the ideal situation necessary to successfully implement the strategy.¹⁷

This mental process strategic thinking is about engaging in a strategic reasoning process and this process consists of two cognitive activities required to define strategic problems, namely identifying problems and diagnosing them to understand their nature as shown above the line and two activities to solve problems, namely conceiving solutions and realising the solutions by implementing the solutions.



Identifying is the mental activity necessary to determine the current situation and recognise a problem. In simple terms it is about seeing and connecting the dots, creating a picture of the situation from which a problem can easily be identified. The problem can be a discrepancy between what is and what should be for the strategy to be successfully implemented. For example, it can be that the strategic leader recognises that the structure of the organisation is not what it should be to implement the strategy or there could be misalignment between subsystems or elements of the organisation. The leadership style within the organisation may not be influencing people to perform in line with its strategic goals and objectives. To be successful in this reasoning process requires the use of increasingly complex mental processes, referred to as cognitive complexity¹⁸ or complicated understanding.¹⁹ This is the cognitive ability to apply multiple, complementary perspectives to describe and analyse events. It 'increases the probability that individuals will perceive events (especially complex events) more accurately, synthesise diverse perceptions and experiences more completely, and generally behave more effectively ... make choices and sustain commitments in the face of ambiguity, relativism, and multiple interpretations of situations.'²⁰ To identify a problem, the strategic leader needs information regarding the current reality of the organisation to make sense of this information and determine any discrepancies (problems).

Once the strategic leader has identified any discrepancies through recognising and sense making, they now need to diagnose. This is a more detailed process of determining the nature (the essence) of what is being faced. This is

necessary because we often identify a problem by observing a symptom (a sign or indication of a problem or situation) which is a mere manifestation (expression) of the problem and not necessarily a true reflection of the real problem which needs to be managed and dealt with. This can be illustrated by a medical example where experiencing severe headaches is a symptom or mere expression of another problem which could be high blood pressure. High blood pressure in this case would be the real problem which needs to be managed and dealt with. See the high absenteeism example later in this section for an example relevant to an organisation.

Diagnosis is done through the mental processes of analysing and reflecting. Analysing is the mental process of breaking the problem down into its component parts and determining its most distinctive elements. Important in analysis is to ask the right questions, such as: 'what is this all about?', 'why is it happening?', 'what is causing it?', 'who is involved?'. Conceptual or mental models influence and guide the questions we ask, and assist in distinguishing between cause and effect (symptoms). Such models are simplifications of reality. They are abstractions of reality and assist us in making sense of the complexity and ambiguity of organisational reality and guide us in what to do. Models identify key elements and the relationships between them. They are like maps that depict key elements or features (physical such as oceans, rivers, mountains; political such as countries, cities, towns; and other features such as roads, monuments, places of interest) of a territory. Maps help us see the bigger picture, navigate, find our current and desired location, and help find other points of interest like a recommended restaurant. In the case of strategic leaders, the organisation is the territory. Just as automotive technicians have mental conceptual models of how an engine ideally works to assist them in being effective in their work, so too do strategic leaders need conceptual models of how organisations should ideally function to implement particular strategies. See [section 12.2.1.1](#) for more on mental models.

Having broken the problem down into its component parts, the strategic leader reflects (thinks through), which may result in being able to identify causes and interrelationships between the components of the problem. High absenteeism is an example of a symptom that can be identified as a problem. To deal effectively with absenteeism, management needs to define and understand the nature of the problem to determine its cause. Knowing this means that solutions can be generated and actions taken to eliminate or reduce the problem.

Having defined the strategic problem by engaging in the cognitive activities of identifying and diagnosing, strategic leaders need to solve the problem by engaging in the activities of conceiving and realising.

In conceiving, the leader needs to imagine how to address the problem and formulate actions to address it. When conceiving, leaders use mental models to assist in providing them with a picture of the ideal situation and guide them in formulating actions to achieve it. The leader is, however, often required to formulate unique solutions as generic solutions are rarely available. While logical thinking is important, strategic leaders also need to think laterally to be able to generate an innovative solution. This requires managers to move from a reductionistic model of the world that depicts it as machinelike, linear, predictable and controllable²¹ to one of complexity.²² They need to 'abandon the ... belief that the world is merely a puzzle to be solved, a machine with instructions waiting to be discovered, a body of information to be fed into a computer.'²³

Puzzles are well-structured problems with only one correct final solution, which can be guaranteed by using a specific known and effective procedure or formula.²⁴ Responding to strategic problems as puzzles results in leaders simply plugging available information into a specific formula and acting on the basis of the solution that emerges. Ill-structured problems, however, are those for which there is no single, unequivocal solution that can be determined at the present moment by employing a particular decision-making procedure or following steps or rules. Ill-structured problems are typical of the type of problems encountered in a complex, ambiguous, rapidly changing environment where there is seldom a single right or wrong answer. These are the problems strategic leaders are increasingly facing²⁵ and need the skills to deal with. Such problems can also be termed 'wicked problems':

- These are challenging to describe
- There is no way of knowing when the solution is found

- The solution is neither right nor wrong
- There is no way to test the effectiveness of the solution
- Solutions cannot be undone as each one has consequences
- There are countless possible solutions
- Every problem is unique with no previous similar problems to inform addressing it
- The problem is interlinked with other problems with no singular root cause
- It involves numerous stakeholders with different views on the nature and cause of the problem
- Because of the wide impact of the consequences of solutions, strategic leaders cannot afford to be wrong because they are held liable for the consequences.²⁶

Strategic leaders in these situations need to be able to think outside the box to develop unique innovative actions or solutions to implement strategy. This requires creative thinking, which is not only needed when conceiving and realising strategic solutions, but also when identifying and diagnosing strategic problems.²⁷

Once a manager has conceived how to address the problem, the focus is on practically implementing the actions to realise its solution and to evaluate the implications of the actions. In cases where action is required, the strategic leader essentially becomes a change agent, responsible then for initiating and managing change.

These strategic thinking activities need not follow a structured and orderly process as presented above. To engage successfully in this process, the manager needs absorptive capacity, adaptive capacity and managerial wisdom:²⁸

- *Absorptive capacity* is the capacity to learn, the ability to 'recognise new information, assimilate it, and apply it toward new ends,²⁹ challenging and even restructuring worldviews or mental models used to make sense of the world.
- *Adaptive capacity* is the ability to be open to and accept change.³⁰ In order to even engage in the strategic reasoning process, the manager first needs to be open to change (willing to deal with or consider it) and intellectually curious and inquisitive about what is happening within and around an organisation.
- *Managerial wisdom* is being able to perceive both external and internal disparity in the environment, understand the stakeholders and their relationships, and take appropriate action at the right time.³¹

All three of these characteristics require an openness to sense what is happening in the organisation and its environment, to transform and make sense of these observations, and to act appropriately on them.

In the reasoning process, the current reality of an organisation needs to be identified and diagnosed. This must then be compared to the manager's mental image of what is ideally needed to successfully implement the strategy. Any gaps/discrepancies (problems) need to be recognised, and solutions conceived and realised to close the gap. Strategic leaders need to be comfortable conceptualising, working with the abstract, theorising and hypothesising in this reasoning process. Mental/conceptual models can be useful in assisting the leaders here.

12.2.1.1 Mental models

*A model is a theory which indicates which factors (in an organisation, for example) are most critical or important. It also indicates how these factors are related or which factors or combination of factors cause other factors to change. In a sense, then, a model is a road map that can be used to make sense of the terrain ... The models we use are critical because they guide our analysis and action.*³²

We all have some sort of implicit models that we have developed over time from our experiences. These models assist us in making sense of the world around us and guiding us in what actions to take, but differ in validity and quality. For example, think of your mental model of how the engine of a car works. This will influence and guide you in what to do when your vehicle fails to start, when it breaks down or what to do to improve the performance or fuel

efficiency of the engine. How effective (doing the right thing) or efficient (doing the right thing in the right way) you are in dealing with the issues or problems with your vehicle's engine will be influenced by the mental model you have of how the engine works. Your mental model may be that you do not even recognise that there is a problem until it is too late. A trained technician with a more valid mental model of how the engine works may be more effective and efficient in dealing with starting problems and breakdowns, or with improving the performance or fuel efficiency of the motor.

Mental models guide strategic leaders in what they consider to be relevant and important or not when engaging in the strategic reasoning process. These models influence what they 'see' and what they do not. Whether or not a manager even identifies a problem will depend on the person's mental model. Similarly, mental models will influence how a manager analyses and defines the nature of a problem or opportunity, as well as how they conceive the action to be taken and its execution.

In addition to the implicit mental models guiding strategic leaders, there are more explicit models that have been scientifically developed and based on theory and/or research. Knowledge of such models and skill in using them is developed typically in management and leadership development and training. This specialised knowledge and skill in the use of models is critical in assisting strategic leaders to deal with ill-structured or wicked problems, and the conceptualising necessary for the implementation of strategy.

Mental models reflect our beliefs, guide our senses, provide an interpretive filter of the importance of issues and the cause and effect relationships between them, and direct behaviour.³³ Strategic leaders need to work with mental models, starting with 'turning the mirror inward; learning to unearth our internal pictures of the world, to bring them to the surface and hold them rigorously to scrutiny'.³⁴

*One thing all managers know is that many of the best ideas never get put into practice. Brilliant strategies fail to get translated into action. ... We are coming increasingly to believe that this ... stems ... from mental models. ... New insights fail to get put into practice because they conflict with deeply held internal images of how the world works, images that limit us to familiar ways of thinking and acting. That is why the discipline of managing mental models – surfacing, testing, and improving our internal pictures of how the world works – promises to be a major breakthrough ...*³⁵

Put another way:

The difficulty though, is that in managing mental models, they are seen to be proven and to make sense. This will be to the point that it does not make any logical sense to change them. Changing times do require that our longstanding mental models change. Changing these mental model requires strategic thinkers to be imaginative and to break away from the conventional.

*When it comes to being imaginative and breaking away from the norm, or accepted way of doing things, think of Elon Musk and his achievements mentioned earlier.*³⁶

When it comes to breaking with the orthodox and making leaps of imagination, think of Elon Musk and his achievements mentioned earlier.

Strategic leaders clearly need to be able to work with mental models, being aware not only of their benefits but also of their potential limitations. They need to be able to think logically as well as laterally to be creative. This, however, does require emotional intelligence, particularly being self-aware of their feelings about uncertainty and ambiguity. Taking leaps of imagination and abandoning rules, steps, logic and the familiar to be creative requires one to be comfortable with uncertainty and ambiguity.

Other than using models in the reasoning process of diagnosing and solving strategic problems, strategic leaders also construct unique business models to represent simply how the organisation will create value and deliver on its

purpose and vision (i.e. the strategy). The statement by Old Mutual Emerging Markets interim CEO, Iain Williamson, clearly highlights the role of a business model in delivering: ‘Our strategy is rooted in our vision and brand promise of “enabling positive futures”. Our customers span all income segments and include both retail and corporate relationships. Our business model uniquely positions us to deliver on this vision.’³⁷

12.2.1.2 Business model

The business model can be defined as:

*... an abstract representation of an organization, be it conceptual, textual, and/or graphical, of all core interrelated architectural, co-operational, and financial arrangements designed and developed by an organization presently and in the future, as well as all core products and/or services the organization offers, or will offer, based on these arrangements that are needed to achieve its strategic goals and objectives.*³⁸

Often included in such models are inputs, processes and activities, stakeholders and their roles, and outputs. The statement made by the Foschini Group, below, provides insight into what a business model does, namely describing activities that guide an organisation towards its vision. For the Foschini Group³⁹ ‘[o]ur business model describes the activities that transform our resources, through a range of business processes, into outputs and outcomes that guide us towards our vision of being the leading fashion lifestyle retailer in Africa whilst growing our international footprint’.

Business models are unique to particular organisations, and require the lateral thinking identified earlier to be able to generate them for a particular strategy and its implementation. They can be presented as textual and/or graphic. Below is an example of a business model in textual form.

CASE EXAMPLE: Lewis Stores’ business model spelt out⁴⁰

Lewis Group continues to operate its proven decentralised, store-based business model which remains appropriate for the group’s lower to middle income target market. The model is based on the principle that the sale of furniture and the granting of credit are largely interdependent as the group’s customers are reliant on credit to buy products. All aspects of the customer relationship are managed by the staff in the stores, except for the granting of credit which is managed centrally to ensure consistent decision-making and prudent credit risk management. The personal and relationship-based interaction with customers in the stores creates trust and confidence while also generating high levels of loyalty and repeat sales. This process is supported by leading technology which removes the administrative burden at store level and enables real-time management reporting. The business model was enhanced in 2016 with the launch of a specialist call centre for South African stores. The call centre aims to further improve compliance, transparency and oversight of the in-store sales and credit application process and limit any potential misunderstandings of the costs, services and fees to be paid by customers. The call centre is housed at the company’s head office and employs 60 consultants who are able to engage with customers in English, Afrikaans, Xhosa, Zulu, Sepedi, Sesotho, Setswana and Xitsonga.

Strategic leaders clearly need to be comfortable in working with mental models, in not only applying them when dealing with strategic problems but also in conceptualising, designing, communicating, interpreting and translating their own unique business models into day-to-day action.

As mentioned, to implement strategy successfully, strategic leaders need a clear conceptual understanding of the organisation as a whole and what is required to ensure that it is enabled to implement the strategy successfully. This requires that strategic leaders think strategically and use models to guide them in making sense of the organisation

and formulating the strategic change initiatives required. In the next section we discuss the second responsibility of a strategic leader, namely to lead the organisation effectively and ethically.

12.3 Lead ethically and effectively for strategic results

Strategic leaders need to get the ball rolling to lead the organisation effectively and ethically for strategic results. The King IV Report on Corporate Governance⁴¹ advises that:

... ethical and effective leadership should complement and reinforce each other. Ethical leadership is exemplified by integrity, competence, responsibility, accountability, fairness and transparency. It involves the anticipation and prevention, or otherwise amelioration, of the negative consequences of the organisation's activities and outputs on the economy, society and the environment and the capitals that it uses and affects. Effective leadership is results-driven. It is about achieving strategic objectives and positive outcomes. Effective leadership includes, but goes beyond, an internal focus on effective and efficient execution.

Effective leaders 'are alike in one crucial way: they all have a high degree of emotional intelligence'⁴².

*In the lower reaches of job complexity there is a more or less direct ratio between a person's cognitive ability and performance, in that a smarter clerk or machine operator will do better than one who is not so bright. But at the higher levels of job complexity – in executive or managerial ranks – IQ and expertise do not predict who will be the standout performers. The immense difference between top and bottom performers in high-complexity jobs makes emotional intelligence not simply additive with cognitive ability, but multiplicative: arguably, the hidden ingredient in star performance.*⁴³

Emotional intelligence is clearly critical for effective strategic leadership.

12.3.1 Emotional intelligence

Emotional intelligence can be understood in terms of the ability to manage both ourselves and our relationships.⁴⁴ The ability to manage ourselves consists of the following competencies:

- *Self-awareness* means being able to identify and understand our own emotions, values and goals, and their impact on others. It is also about knowing our strengths and weaknesses. Self-aware leaders know where they are going and why, understand their competencies, and have a strong sense of self-worth.
- *Self-regulation* is about being able to control our impulses and behave appropriately in a range of situations. It involves displaying honesty and integrity, taking responsibility for our own performance, being open to change, and being comfortable with novelty and ambiguity.
- *Motivation* is about passion and energy, striving for improvement, readiness to act on opportunities, and pursuing goals despite difficulties. It is also about working for reasons other than financial gain and status.

When handling relationships, the following competencies are relevant:

- *Empathy* is about being aware of and understanding other people, as well as being able to respond appropriately to them according to their reactions. It is about the development of other people, being sensitive to diversity, and anticipating, identifying and meeting the needs of others.
- *Social skills* concern eliciting appropriate responses from people. They include the ability to listen and communicate effectively, and build rapport and networks. The leader with good social skills initiates and manages change, influences others, and promotes teamwork and cooperation.

Emotional intelligence assists leaders in achieving desired results by employing the right type of leadership style (behaviour) for any business situation, in essence demonstrating what is termed behavioural complexity.⁴⁵

12.3.2 Leadership style (behaviour)

To get the ball rolling and to achieve results, strategic leaders need to act. A leadership style is a set of characteristic behaviours or the characteristic manner in which a leader will go about fulfilling his or her role in order to achieve results, for example the manner in which a leader provides direction, implement plans or influences people to achieve results. Part of effective strategic leadership is having the wisdom to select the appropriate behaviour from a range of behaviours (styles) for each specific situation. In other words, strategic leaders need to be able to behave in a complex manner, meaning that they need a range of behaviours at their disposal, and the ability to apply them in the right combination at the right time in the right context.

In explaining the idea that leaders need to use a collection of leadership styles in the right measure at the right time to achieve results, Goleman used the game of golf as an analogy:

Imagine the styles as the array of clubs in a golf pro's bag. Over the course of a game, the pro picks and chooses clubs based on the demands of the shot. Sometimes he has to ponder his selection, but usually it is automatic.

The pro senses the challenge ahead, swiftly pulls out the right tool, and elegantly puts it to work.⁴⁶

The various golf clubs referred to by Goleman in the quote above can be likened to various leadership styles. A leadership style is a set of behaviours, which refers to the way or manner in which a leader goes about fulfilling his or her responsibility, be it, for example, providing direction, motivating people, communicating with people, making decisions or implementing strategy.

One way to understand leadership styles is to consider the seven styles identified by Bass and Avolio,⁴⁷ and classified as either transactional or transformational leadership:

- *Transactional leadership* is based on an exchange (a transaction or agreement) between the leader and follower whereby the leader clarifies what is required of the follower and the consequences of the requirements being met.⁴⁸ Transactional leadership typically results in expectations being met.
- *Transformational leadership* results in the follower being motivated to achieve more than intended or even thought to be possible.⁴⁹ This is achieved by the transformational leader behaving differently from the transactional leader.

The behaviours or styles of both transactional and transformational leaders can be understood in terms of [Figure 12.1](#).

To be effective, strategic leaders need to apply the full range of leadership styles described by Bass and Avolio with a focus on the transformational styles. The various styles are described on the next page.

Figure 12.1 Full range leadership development theory⁵⁰

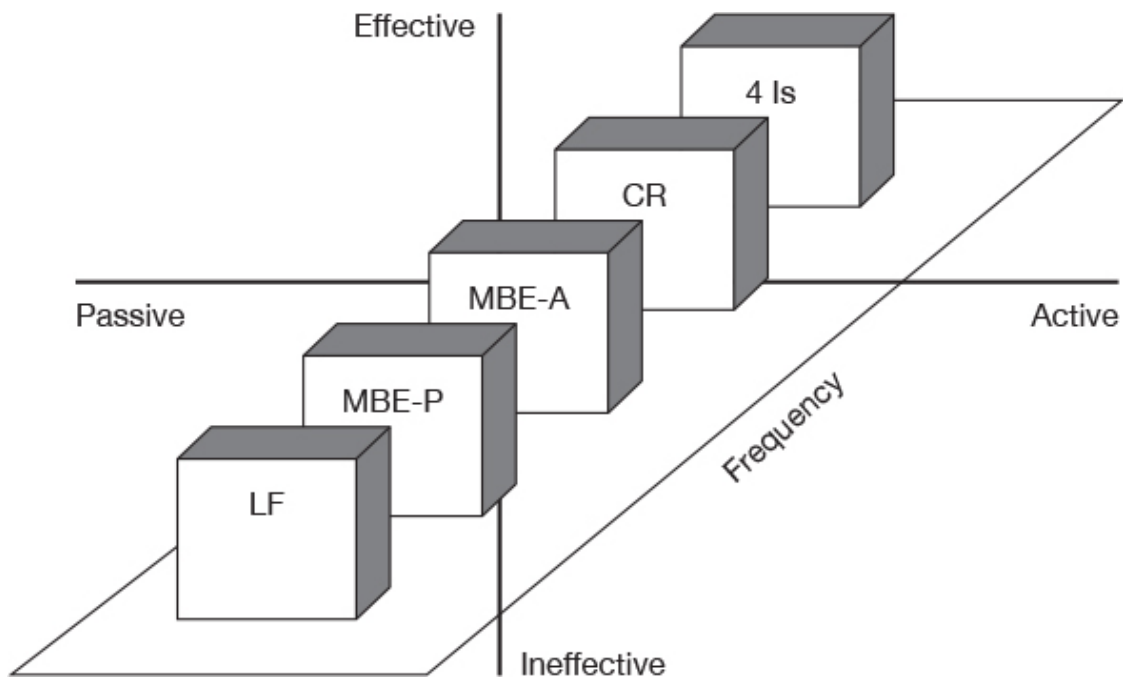


Figure 12.1 illustrates leadership styles in terms of the extent to which each is active, passive, effective and ineffective, as well as in terms of the extent (frequency) to which they are exhibited by a leader. Transformational leadership is an extension of transactional leadership, and should be exhibited more frequently if the leader is to improve the effectiveness of an organisation.

In Figure 12.1, the transactional factors include contingent reward (CR) and management-by-exception (MBE):

- Contingent reward (CR) is an active and effective component of leadership as the leader compensates or rewards a subordinate appropriately for meeting agreed-upon objectives.
- Management-by-exception passive (MBE-P) occurs where leaders react and intervene in the work of subordinates only when mistakes occur or standards are not met.
- Management-by-exception active (MBE-A) occurs where the leader actively monitors and seeks out deviations and mistakes in the work of subordinates, and intervenes personally to take corrective action. This approach tends to generate tension and fear. MBE-A is more active and more effective than MBE-P.

Laissez-faire (LF) is an absence of leadership and is not seen to be part of transactional or transformational leadership. This leadership behaviour is both passive and ineffective as the leader remains uninvolved and avoids leading.

Transformational leadership has produced improved employee outcomes in many different types of organisations⁵¹ and consists of the four Is, namely idealised influence, inspirational motivation, individualised consideration and intellectual stimulation:⁵²

- *Idealised influence* occurs where leaders consider the needs of others over their own, demonstrate high standards and ethical and moral conduct, and are consistent. The leader generates admiration, respect and trust in others who want to emulate the leader. Idealised influence with its focus on ethical and moral conduct and others wanting to emulate the leader has an ethical component.⁵³ Ethical conduct is critical within organisations and leaders are ‘a key source of ethical guidance for employees.’⁵⁴ This requires **ethical leadership** on the part of strategic leaders, which is ‘exemplified by integrity, competence, responsibility, accountability, fairness and transparency.’⁵⁵

- *Inspirational motivation* occurs where leaders provide meaning and challenge to followers by articulating and communicating a clear, concise and persuasive vision of the future. They delegate power and are able to establish a sense of team spirit in an exciting and challenging work environment. This behaviour inspires and motivates followers.
- *Individualised consideration* occurs where leaders pay special attention to people as individuals and consider their individual needs and competencies as opposed to treating everyone alike. The leader encourages two-way communication, and listens and delegates to individuals as a means of development. This behaviour of leaders demonstrates that they accept differences.
- *Intellectual stimulation* occurs where leaders stimulate followers to think for themselves and to think differently about situations. Leaders challenge followers to question, redefine problems, question assumptions, be creative and innovative in their work, and to respond to old situations in new ways. They are encouraged to solve problems themselves. Mistakes are not criticised, but are seen as opportunities for learning.

Similar to the argument outlined above for a combination of transactional and transformational leadership, Rowe⁵⁶ argued that strategic leadership synergistically combines both managerial and visionary leadership, as outlined in Table 12.1. Managerial leadership concerns day-to-day activities and the short-term focusing on operational excellence, and can be likened to transactional leadership. It involves stability, order and the preservation of the existing order of the organisation with a low level of emotional involvement with others. Visionary leadership, however, can be likened to transformational leadership, and is future orientated, proactively shapes ideas, and relates to people in empathetic ways to ensure the future of the organisation. Effective strategic leaders need to be able to, in terms of Rowe's conceptualisation of leadership, combine both managerial and visionary leadership. This is similar to the idea of Bass and Avolio outlined earlier – that effective strategic leaders need to be able to apply the full range of leadership styles, both transactional and transformational, with a focus on the transformational styles.

Table 12.1 Strategic, visionary and managerial leadership⁵⁷

Strategic leaders		
• Have a synergistic combination of managerial and visionary leadership. • Emphasise ethical behaviour and value-based decisions. • Oversee operating (day-to-day) and strategic (long-term) responsibilities. • Formulate and implement strategies for immediate impact and the preservation of long-term goals to enhance organisational survival, growth and long-term viability. • Have strong, positive expectations of the performance they expect from their superiors, peers, subordinates and themselves. • Use strategic and financial controls, with emphasis on the former. • Use and interchange tacit and explicit knowledge on individual and organisational levels. • Use linear (logical – following steps) and non-linear (multidirectional) thinking. • Believe in strategic choice, i.e. their choices make a difference in their organisations and environment. • Strategic leaders includes visionary leaders and managerial leaders.		
Visionary leaders	Managerial leaders	
• Are proactive, shape ideas and change the way people think about what is desirable, possible and necessary. • Work to develop choices and fresh approaches to longstanding problems, and work from high-risk positions. • Are concerned with ideas, and relate to people in intuitive and empathetic ways. • Feel separate from their environment; work in, but do not belong to, organisations; their sense of who they are does not depend on work.	• Are reactive; adopt passive attitudes towards goals; goals arise out of necessities, not desires and dreams; goals are based on the past. • View work as an enabling process involving some combination of ideas and people interacting to establish strategies. • Relate to people according to their roles in the decision-making process. • See themselves as conservators and regulators of existing order; their sense of who they are depends on	

• Influence attitudes and opinions of others in the organisation. • Are concerned with ensuring the future of the organisation, especially through the development and management of people. • Are more embedded in complexity, ambiguity and information overload; engage in multifunctional, integrative tasks.	• their role in the organisation. • Influence actions and decisions of those with whom they work. • Are involved in situations and contexts characteristic of day-to-day activities. • Are concerned with, and more comfortable in, functional areas of responsibilities.
• Know less than their functional area experts. • Are more likely to make decisions based on values. • Are more willing to invest in innovation, human capital, and creating and maintaining an effective culture to ensure long-term viability. • Focus on tacit knowledge, and develop strategies as communal forms of tacit knowledge that promote enactment of a vision. • Use non-linear thinking. • Believe in strategic choice, i.e. their choices make a difference in their organisations and environment.	• Are experts in their functional area. • Are less likely to make value-based decisions. • Engage in and support short-term, least-cost behaviour to enhance financial performance figures. • Focus on managing the exchange and combination of explicit knowledge and on ensuring compliance with standard operating procedures. • Use linear thinking. • Believe in determinism, i.e. the choices they make are determined by their internal and external environments.

As noted earlier, effective strategic leadership is having the wisdom to select the appropriate behaviour from a range of behaviours (styles) for each specific situation. The next section addresses the need for strategic leaders to be sensitive to the culture of people when leading.

12.3.3 Cultural conditioning of leadership behaviour

Strategic leaders need to be aware though that they ‘cannot choose their style at will; what is feasible depends to a large extent on the cultural conditioning of the leader’s subordinates.’⁵⁸ South Africa, with its cultural diversity and 11 official languages, is known as the ‘Rainbow Nation’. Understanding and being sensitive to the culture of people is important for leadership effectiveness. This is because ‘one of the most important tasks of leadership in business involves connecting the internal culture of the enterprise to the social and cultural values of the people who work there.’⁵⁹ In light of this, strategic leaders need to be aware that there is increasing criticism of the assumption that Western leadership theory and models are universal. The argument is that if a leader is to be successful, the style adopted by that leader needs to be congruent with prevailing values. This has implications for business leaders not only in South Africa, but also for those expatriates in managerial roles in countries outside South Africa. It is important to understand the prevailing national cultural value system before simply applying ‘foreign’ leadership theory.

In South Africa, the notion of **ubuntu** provides insight into the prevailing philosophical values system ‘as a mode through which reality is constructed and shared.’⁶⁰ This philosophy is ‘captured in the Zulu expression *umuntu ngumuntu ngabantu*, or “I am because you are, you are because we are” ’.⁶¹ This clearly conditions us as South Africans and is an important consideration for strategic leaders seeking to lead effectively. ‘Ubuntu is characterised by such values as caring, reciprocity, sharing, compassion, hospitality, cohabitation, cooperation and tolerance’⁶² This implies humanness and that strategic leaders should show humility, compassion and tolerance.⁶³ Ubuntu also supports the ‘idea of interdependence between organisations and society’⁶⁴ and that the organisation has corporate citizen status by virtue of being an integral part of society.⁶⁵ Top management then ‘takes account of the legitimate and reasonable needs, interests and expectations of all material stakeholders in the execution of its duties in the best

interests of the organisation over time.⁶⁶ Adopting a stakeholder-inclusive approach means that management needs to see the big picture and balance stakeholder interests.

In South Africa, it is argued that this community concept of leadership is required. Wendy Lucas-Bull, former FNB Retail CEO, writes:

*Though the Western style of leadership tends to favour the powerful and sometimes arrogant, who assert their individuality and thrive in a hierarchical environment, the African leader ... is completely different. Such leaders have a different agenda from their Western counterparts, favouring communal solutions, where trust and consultation form the basis for negotiations and the interests of the whole community far transcend individual interests. It takes a remarkable leader to put aside the desire for personal power and glory and instead, in the style of a true African leader, focus on the needs of all people. Such a leader can inspire unimaginable feats of reconciliation through humility, a willingness to serve others and a true love and concern for the people.*⁶⁷

Nelson Mandela is an icon of African leadership, which has 'a strong philosophical base in the concept of ubuntu'.⁶⁸ According to ubuntu, a person is a human being only because of the existence of other people. See the following example of leadership through ubuntu.

CASE EXAMPLE: Leadership through ubuntu⁶⁹

Like no other modern leader, Nelson Mandela personifies the defining characteristics of a uniquely African style of leadership built on the concept of ubuntu. This philosophy of African humanism – which is not unique to Africa, but has long been in sad decline in the developed world – is based on integrity, compassion and humility, which are all founded on the sense of self-worth that comes from belonging to an integrated community. Whether in social life or political structures, the culture of African social organisation has always embraced collective effort guided by what Reuel Khoza has called 'servant leaders'. What Mandela challenged us to do is to rediscover the roots of Africa's leadership principles and to lead the world to embrace a more humane and more effective style of leadership. Mandela's approach to leadership is more than an organisational principle or a contrived ideal – it is predicated on a moral philosophy that places the community at the centre of our worldview. Moreover, the centrality of people in Mandela's approach underscores a deep-seated belief in the importance of relationships – in our personal life and in business. Business is always about people, and we should emulate his approach because people should always be treated with dignity, respect, and compassion. It promotes the community as one supported by the intimacy of close-knit interpersonal relationships and group interactions welded together by a feeling of security and harmony on the part of all its members. However, this is not to say the individual is an unimportant automaton submerged in the anonymity of the collective, since respect for the individual remains of paramount importance as an affirmation of human dignity within the community. It is also expressed in the South African Constitution. Ubuntu is at one with the constitution in its rejection of people's exploitation by people and of discrimination based on race, gender, or creed. In its broadest sense, ubuntu is an endorsement of the unity of humankind, an insistence that government is based on the will of the people, and that all men and women are equally protected before the law, entitled to equal opportunity and the freedom to make political choices, and to participate in the cultural life they choose.

To nurture and protect the tenets of ubuntu, leaders of consequence must be the custodians of a nation's ideals, the values it cherishes, and the confidence that makes a nation out of individuals and classes. In playing this unifying role, the value of the symbolic gesture is inestimable. Given Mandela's grasp of this truism, it is no surprise that in his hands such gestures are profoundly honest. When he visited Betsie Verwoerd, there was never a suggestion that this was the hollow show of a politician. And on that glorious afternoon in the winter of 1995 when he wore the Springbok rugby jersey, it was a gesture that achieved more than a thousand stirring orations. When he held aloft the soccer World Cup in Zurich after South Africa had won the bid to host the 2010 competition, the whole world took notice. In those moments, Madiba was one of us, the embodiment of all our

hopes and aspirations for a common homeland. But there is also a hard and uncompromising edge to Mandela's leadership. The rigidity of his self-discipline, the spartan nature of his life, the fearlessness with which he intervenes in sensitive international issues, all demonstrate a man whose adherence to principle and conviction is immovable. It was a characteristic of his presidency that he left the day-to-day business of government to others, but his insistence on the moral qualities of rule and the virtues of selfless service were impressed on all to whom he had entrusted the gift of leadership. The notion that African leadership means service to humanity – servant leadership – has found its highest expression in the person of Mandela.

For successful strategy implementation, strategic leaders are responsible for influencing others, requiring them to behave appropriately and ethically to achieve positive results. Part of this leadership responsibility is to develop and communicate a compelling vision to lead change and to translate the direction into clear concrete deliverables and measures, as discussed in the next section.

12.4 Develop and communicate a compelling vision to lead change

It is people who 'contribute individually and collectively to an organisation's achievement of its strategic objectives and its maintenance of a competitive advantage.'⁷⁰ Strategic leaders need to work with and through the people of an organisation to implement strategy and ensure its continued survival and success. People need to know what to do and to be supported in getting it done.

For strategy to be successfully implemented, people need to be directed, inspired and motivated to act (behave) in ways to implement strategy successfully. Strategic leaders need to steer and set strategic direction with regard to the organisation's strategy.⁷¹ Recall from earlier in the chapter that inspirational motivation occurs where leaders provide meaning and challenge to followers by articulating and communicating a clear, concise and persuasive vision of the future and that this behaviour inspires and motivates followers. Recall also the concept of visionary leadership.

Getting the ball rolling all starts with a dream that envisions the future. An example of this is the Murray & Robert's Dream of 2025:⁷² 'By 2025, we strive to be a leading multinational engineering and construction group that applies our project life cycle capabilities to optimise fixed capital investment'.

'In some ways leaders live their lives backward. They see pictures in their mind's eye of what the results will look like even before they've started their project, much as an architect draws a blueprint or an engineer builds a model. Their clear image of the future pulls them forward.'⁷³ Leaders cannot achieve their dreams alone. 'A person with no constituents is not a leader, and people will not follow until they accept a vision as their own.'⁷⁴

Strategic leaders need to envision how things can be and paint a clear picture of this for everyone in the organisation to see, understand and be inspired to act on. A vision needs to clarify the direction in which an organisation needs to move, beckon the organisation in that direction and energise people for the action necessary to implement the vision. Given the important role of a vision in creating action for implementation, it is important for strategic leaders to craft a vision specifically to create the action, commitment and inspiration necessary for implementation. A good vision consists of two major components:

- Core ideology
- Envisioned future.⁷⁵

Core ideology is comprised of core values and core purpose.⁷⁶ Core values are essential in developing a sense of what the organisation stands for, and need to be asserted explicitly and made real. Another component of core

ideology is core purpose. Purpose is an outgrowth of core values, explicitly stating the organisation's reason for existing and is therefore always worked towards, but never fully achieved.⁷⁷ Ghoshal and Bartlett⁷⁸ argue that because organisations in modern society play a role as the most important forums for social interactions and personal fulfilment, top executives need to see themselves not simply as the designers of corporate strategy but as the shapers of institutional purpose. For Ghoshal and Bartlett,⁷⁹ 'strategies can engender strong, enduring emotional attachments only when they are embedded in a broader organisational purpose'. The authors⁸⁰ go on to argue that 'today, the corporate leader's greatest challenge is to create a sense of meaning within the company, which its members can identify with, in which they share a feeling of pride, and to which they are willing to commit themselves'. The purpose transcends the narrow self-interest of a company and is linked to broader human aspirations worthy of long-term pursuit.

The second major component of a good vision is envisioned future, which consists of a 10-to-30-year Big, Hair, Audacious Goal (BHAG) as well as a vivid description of what it will be like to achieve it. As a catalyst for team spirit, a BHAG serves as a unifying focus of effort.⁸¹ As such, it needs to be clear and persuasive, requiring little to no explanation so that staff grasp it immediately.⁸² Refer to [Chapter 3](#) for a more detailed discussion of strategic direction.

Nutt and Backoff⁸³ identify four criteria that can be used to guide the crafting of a vision:

- Possibility: Offering an innovative and energetic image of the future
- Desirability: Alignment of the vision with organisation values and culture
- Actionability: Indicating the role of organisational members and what they can do to accomplish the vision
- Articulation: Ensuring clarity and using powerful imagery to create a picture in the minds of organisational members of what is wanted.

Critical here is communication in, firstly, building a shared vision. Communication needs to be effective throughout the organisation across functional and hierarchical levels using a variety of channels or media, and tailored to the different audiences with feedback channels built in. What and how strategic leaders communicate is very much influenced by who they are as individual leaders and their skills, but it is important to listen and be open to receiving feedback.

Strategy, vision and long-term strategic goals need to be translated and cascaded throughout the organisation. Not only must the strategic direction be communicated to educate and inspire people but also to guide them on what to do practically in the here and now in order to implement strategy. A useful tool assisting here is the balanced scorecard,⁸⁴ which helps translate rather abstract strategic direction into more concrete operational objectives and measures for all the various functions, divisions, departments, sections, teams and individuals as performance indicators and measures. This then helps managers monitor and control progress towards implementing strategy, and guides managers within the organisation and staff on what is expected of them and what to do. The age old saying 'what you measure is what you get' implies that what is measured and how it is measured communicates expectations and influences what people do. The balanced scorecard importantly alerts us to the idea of balanced controls, that financial measures alone are limited to successful strategy implementation and that additional measures are required to guide people and provide performance feedback. These areas include but are not limited to customers (eg customer satisfaction), internal business processes and staff satisfaction.⁸⁵ See [Chapter 3](#) for more on the balanced scorecard as a tool for translating strategic direction into operational terms.

Strategic thinking is required for top managers to visualise the practical implications of the strategy for all the functional areas of the organisation (marketing, finance, human resource management, production and so on) and to ensure that each functional area individually and collectively contributes to what is required to action the strategy. Each functional area needs to have their own strategy aligned to the overall strategy of the organisation and ensure that the strategy is implemented to drive corporate strategy.

It must be remembered that managers at the various managerial levels have an important role to play in communicating direction. Communication is not the exclusive responsibility of strategic leaders. All managers need to know and understand the strategy and vision, and be able to translate this into clear day-to-day actions. Strategic leaders need to ensure that there is appropriate leadership within the organisation to achieve this, a responsibility on which section 12.4.2 focuses. Knowing to ask the following questions can assist managers at all levels in clarifying what needs to be done practically to implement strategy, especially within their particular functions:

- What are we doing today?
- Why are you doing the work you are doing? Why now?
- How does what we are doing today align with the bigger picture?
- What does success look like for our team?
- What else could we do to achieve more, better, faster?⁸⁶

Successful implementation requires more than developing and communicating a compelling vision and translating the strategic direction into more concrete operational objectives and measures. We now consider the responsibility of strategic leaders to create an integrated organisational system to support strategy implementation.

12.5 Create an integrated organisational system to enable strategy implementation

Strategic leaders need to visualise the organisation as a whole to be able to implement strategy across cross-functional activities in the organisation. As Higgins⁸⁷ cautions:

*... because most organisations and business units are structured along functional lines – marketing, operations, finance, human resources, R&D, information, logistics – cross-functional execution issues are sometimes overlooked when strategy is changed. For strategy to succeed, cross-functional organisational factors such as structure, systems and processes, leadership style, staff, resources, and shared values need to be aligned requiring cross-functional thinking on the part of top management.*⁸⁸

Top managers need to identify and understand the various elements (structure, systems and processes, leadership style, staff, resources and shared values) of an organisation and their interrelationships with the aim of aligning these cross-functional organisational factors, not only with each other, but also with the overall strategy of the organisation⁸⁹ in order to implement the strategy. For successful implementation, leaders need to establish fit or congruence, which is ‘the degree to which the needs, demands, goals, objectives and/or structures of one component are consistent with the needs, demands, goals, objectives and/or structure of another component.’⁹⁰

This activity can be likened to the job of a watchmaker. The person needs to manufacture a number of components, each different with its own function. The watchmaker then assembles each part to work together with every other component to create an internal mechanism to work as an integrated whole in order to turn the hands on the dial for an accurate timepiece, measuring the passage of time. As discussed earlier, conceptual models play a useful role in assisting leaders with this activity – to see the big picture, make sense of the organisation as a whole, and identify, diagnose, formulate solutions and initiate required change to create an organisational system that will enable successful strategy implementation.

In creating the integrated organisational system, the following tasks need to be fulfilled by strategic leaders:

1. Design and implement an appropriate organisational structural subsystem.
2. Staff the organisation and ensure social capital.
3. Ensure appropriate leadership within the organisation.

4. Create organisational culture and influence climate.
 5. Build, use and grow distinctive organisational capabilities aligned to the strategy.
- We will now look at each one of these tasks in more detail.

12.5.1 Design and implement an appropriate organisational structural subsystem

The structural subsystem refers to how the work that needs to be done is allocated to various jobs and departments, as well as the policies and procedures that direct how the organisation operates. This subsystem concerns consideration of the elements of organisational structure such as the degree of differentiation or specialisation in terms of different forms of departmentalisation, the degree of standardisation of procedures, coordination procedures and the distribution of authority. The structural subsystem is usually graphically represented in the form of an organisational chart (organigram) that displays various jobs and how they are arranged. From this, one observes various levels and relationships within an organisation. [Chapter 13](#) focuses on this subsystem in more detail. Also, as part of the structural subsystem, organisations design frameworks depicting their value creation process or sustainability framework.

Strategy determines the task of the organisation, meaning the work the organisation needs to do.⁹¹ Strategic leaders need to enable the execution of the work. They do this by designing and implementing an appropriate organisational structure (typically depicted as the organisational chart). This entails breaking the work into jobs that define the tasks, duties, responsibilities and output expected from someone occupying a specific job and arranging the jobs in the form of a structure to direct activity towards the implementation of strategy. In designing the structure, typical organisational structure considerations such as division of labour, departmentalisation or functional arrangements, span of control, delegation of authority, line versus staff authority, and decentralisation compared to centralisation need to be considered.

Part of organisational structure is the structuring of the functional areas of the organisation such as marketing, human resource management, finance, production and others to enable the implementation of strategy. It may also be that a strategy requires flexible production configurations and networks. See [Chapter 13, section 13.3.4](#) for more on organisational structure. It is important for strategic leaders to provide strategic direction for all the functional areas in the organisation to ensure that each is not only vertically aligned with the strategy, but also horizontally aligned with the other functional areas to create a mutually supportive integrated system.

An example of the need for strategic leaders to consider and structure each functional area appropriately is provided by Woolworths Holdings Limited. Their talent requirements have implications for the strategy and structure of the HRM function for example, and strategic leaders need to see this and design and implement appropriate structures aligned with the strategy to enable successful implementation.

This implies that the HRM function has a critical role to play in the implementation of strategy, and needs to be structured to fulfil its strategic role to support it. The HRM function not only needs to be vertically aligned with the organisation's strategy, but all HR activities also need to be aligned with each other to act as an integrated whole aligned with the other organisational factors.

From a good governance perspective (see [section 12.7](#)), governing structures should also be established with appropriate committees such as an audit committee, a committee responsible for nominations of members of the governing body (board), a risk governance committee, a remuneration committee, and a social and ethics committee.⁹² Part of this is determining 'if and when to delegate particular roles and responsibilities.'⁹³

Essentially, top management needs to see the bigger picture, apply the principles and associated practices of good governance, and design and implement the structure necessary to implement the strategy. An example that illustrates structuring at the strategic level is Old Mutual,⁹⁴ who changed their structure to unlock and create value: 'In March 2016, we announced a new strategy for Old Mutual plc that seeks to unlock and create significant long-

term value for our shareholders. This will be achieved through the separation of the four underlying businesses – Old Mutual Emerging Markets (OMEM), Old Mutual Wealth (OMW), Nedbank and OM Asset Management (OMAM) – from each other.’

Systems and processes as mechanisms to facilitate coordination also need to be designed and implemented to be aligned to the strategy and other organisational factors. Processes facilitate organisational functioning and can be categorised according to management, and operational and support processes. Examples of processes may include the supply chain, stock system, budgeting, quality control, governance, knowledge management, organisational learning, internal communications, strategic planning, the manufacturing process, the information technology infrastructure (with its mail system, financial record system, and stakeholder engagement process to name a few), and the point of sale system. See [Chapter 13, section 13.3.3](#) for more on processes. This also entails formulating and approving policy relevant to these areas, considering the need for policy to give effect to the strategy. As was noted earlier, the King IV Report on Corporate Governance identifies the responsibility to approve policy and planning that give effect to the strategy and the set direction.⁹⁵

The next section addresses the staffing of an organisational structure as another task to be fulfilled by strategic leaders in creating an integrated organisation.

12.5.2 Staff the organisation and ensure social capital

People are critical to all organisations. For successful strategy implementation, the right number of staff with the right talent is required as highlighted in the examples below. The importance of attracting and retaining people is evident in the statement below from Woolworths Holdings Limited.⁹⁶

We recognise that attracting and retaining talented employees is critical to delivering our strategy. Competition for talented employees is intensifying, with targeted recruitment and poaching of core talent by local and international retailers offering above market-related salaries. In South Africa, we have a further obligation to transform WSA in line with the revised BBBEE Codes of Good Practice. Similarly, attracting and retaining people is regarded as a key differentiator at Sanlam Group.⁹⁷ Diligent execution on the strategy has been, and remains, a key differentiator for Sanlam, and is enabled by our ability to attract and retain the best skills available in the market.

Top management is ultimately responsible for staffing the organisation and managing social capital so that strategy can be successfully implemented. They need to make sure that the organisation is able to attract and retain talented employees and that people behave in a way aligned to successfully implement the strategy.

Different strategies though, for example cost or differentiation, require different numbers and types of employees with different types of skills, attitudes and behaviours.⁹⁸ They also require different types of HRM strategies, systems and processes. Take, for example, the strategy of differentiation through innovation. The behavioural imperatives for innovation include behaviours such as ‘experimentation, risk taking, accepting failure as normal, project management and team work ... that lead to the birth of new ideas as well as behaviours that lead to developing new ideas into usable products or services that can be delivered to the market in a timely manner.’⁹⁹ Learning and the development of knowledge are critical for innovation. They may require the organisation to become a learning organisation that is able not only to acquire, create and transfer knowledge, but also to change behaviour to reflect the new knowledge.

The strategy of differentiation through quality, for example, requires staff to provide a quality service by assisting customers, instilling trust, providing individualised attention, and being able to diagnose and solve problems to the satisfaction of the customer.¹⁰⁰ However, behavioural imperatives relevant to a cost leadership strategy include accepting part-time or shift work, minimal fringe benefits and performing efficiently.¹⁰¹

To ensure that the organisation is appropriately staffed and led, strategic leaders need to structure and develop the HRM function to ensure not only the availability of the right number of people with the right skills, but also, in collaboration with line managers, that they display the behavioural imperatives of a particular strategy. This can be achieved through the appropriate management of HR activities, systems and processes, and the creation of an enabling environment to leverage the human capital. Such HR activities, systems and processes include HR forecasting and planning, job analysis, job design, recruitment, selection, on-boarding of staff, training and development, performance management, compensation and rewards, as well as labour relations systems such as grievance, disciplinary and dispute procedures. Examples of the key role of HRM and its activities in enabling strategy can be seen from the Strategy in action cases that follow on the next page.

STRATEGY IN ACTION: Sasol and Woolworths Holdings Limited



Key strategy enabler at Sasol – human capital management¹⁰²

Human capital management is key in enabling the execution of our Group business strategy. We continued to focus on building a resilient and engaged workforce. By leveraging the skills, experience, diversity and productivity of our people, we are able to operate our facilities safely, reliably and sustainably, and deliver on our growth objectives. To this end, we continued to invest in sponsored study, technical learning programmes, as well as leadership, career, succession development interventions and critical skills development to secure a pipeline of future talent.

Retail skills required by Woolworths Holdings Limited¹⁰³

The Group's business model is built on differentiation through product and customer experience. This means that the Group requires talent with deep technical and specialist retail skills which are not always readily available in the market. Our transformation strategy is therefore premised on a philosophy of 'retain, develop and grow from within'. Skills development continues to be a key focus area for us as an enabler of this strategy.

From the two examples above it is clear that the talent required by the Woolworths strategy is not always readily available in the market and that the execution of the Group business strategy of Sasol requires a resilient and engaged workforce.

Questions

1. Discuss why HRM activities can be critical to enabling strategy with reference to the Sasol and Woolworths examples.
2. Identify the responsibilities of strategic leaders with regard to staffing and organisation, and ensuring human capital for strategy implementation. Use examples from the Strategy in action case to illustrate your points.

In managing human capital, strategic leaders also need to ensure that they consider and at least comply with relevant legislation. Important in South Africa is legislation pertaining to employment equity and skills development, which has implications for HRM practices relating to, in particular but not limited to, staffing and development. Organisations need to report on employment equity and skills development. On diversity and inclusion, the Barloworld Social, Ethics and Transformation Committee '[a]pproved the revised diversity and inclusion targets for the group for 2018, 2020 and 2022 by gender, race and grade. The strategy involves identifying and eliminating any employment barriers, perceived or real, and to promote demographic representation in the workplace that more closely resembles that of the communities in which we operate.'¹⁰⁴

12.5.3 Ensure appropriate leadership within the organisation

Top management is ultimately responsible for guiding organisations (leadership 'of') and ensuring that strategy is implemented successfully. For successful strategy implementation, there needs to be leadership not only 'of' the organisation. Strategic leaders need to ensure that there is appropriate leadership 'in' the organisation at various levels – leadership able to influence people and elicit behaviour aligned to the successful implementation of strategy. To implement strategy successfully, strategic leaders need to surround themselves wisely with the necessary leadership throughout the organisation able to influence people appropriately to implement strategy. In fact, it would not have been possible for Harry Oppenheimer to have built Anglo American into the world giant it is today had he not wisely surrounded himself with young executives with that special quality of leadership. Similarly, Donald Gordon could not have built Liberty Life, or Anton Rupert the great Rembrandt group without employing and empowering other leaders.¹⁰⁵

Middle managers and operational managers, including supervisors, all need to be able to work with and make practical sense of strategy and communicate direction. Middle managers need to be able to interpret the corporate strategy and formulate **functional strategy**, translating it into more concrete operational objectives and measures. These are communicated down to operational managers and supervisors to implement at the so-called coalface of the organisation. These managers then need to communicate and clarify performance indicators and measures for their teams and individual staff members, ensuring that they know what they are expected to do. It is here that managers apply the performance management system of the organisation and enter into performance agreements with staff members, which assist in ensuring that they are trained and developed to do their jobs and know what is expected of them. This managerial work also requires strategic thinking and being able to use the balanced scorecard¹⁰⁶ as a tool in translating strategy into practical performance indicators and measures. Strategic awareness, then, should not be limited to the top echelons of the organisations, but should be pushed deep down.¹⁰⁷

These managers at the coalface are the ones who execute strategy at the operational level and need to engage staff fully. They work with and through staff at the operational level, leading them to act in line with their individual performance indicators and measures. These managers monitor performance, provide feedback and ultimately manage the performance of the workforce.

Middle managers responsible for functions (functional managers) in an organisation are responsible for the strategic leadership of their functions. They are guided by the overall strategic direction provided by top management. These functional managers (eg HRM, marketing finance, production managers) all need to ensure that they achieve strategic integration (vertical integration) and coherence (horizontal integration) in the development of the policies and practices of their functional area.¹⁰⁸ Strategic integration refers to management ensuring that functional strategies are integrated with and support the overall strategy of the business, while coherence refers to the need for unified and mutually supportive policies and practices.

Top-level managers need to be able to influence others, and so too must managers at the various levels in the organisation. The best organisations are said to have effective leadership demonstrated at all levels.¹⁰⁹ The metaphor of rowing, where a crew propels a boat (racing shell) on water using oars, illustrates the important role of leadership.

*Despite the rowers' best efforts to move the shell, the crew's success depends on the coxswain to steer the boat to the finish line and to coordinate their efforts. Without the leadership of the coxswain, greater effort by the crew could simply result in the shell going round and round, but ever faster. The steering and coordinating of team efforts is the task of the organisational leader, a process that is best done through strategic planning. Without such leadership exercised throughout the strategic planning process, the organisation most likely will be directionless.*¹¹⁰

There are many definitions, theories, and interpretations of what leadership means. In spite of the many definitions of leadership the similarity among the various definitions permits the following description:

*Leadership has been conceived as the focus of group processes, as a matter of personality, as a matter of inducing compliance, as the exercise of influence, as particular behaviours, as a form of persuasion, as a power relation, as an instrument to achieve goals, as an effect of interaction, as a differentiated role, as an initiation of structure, and as many combinations of this definition.*¹¹¹

Simply put, leadership is the ability of one person to influence and enable another to move in a certain direction. Since all employees are participants in strategy implementation,¹¹² leadership is about influencing the behaviour of staff throughout the organisation to be aligned to the strategy. This is critical to successful strategy implementation, as behaviour drives strategy. The managers within the organisation need to develop the leadership required by the strategy of the organisation. In addition to strategic awareness, they need to develop emotional intelligence and be able to employ the right leadership style for a situation, congruent with the prevailing value system and the strategy. They also need to demonstrate transformational leadership.

Strategic leadership must not only ensure that there is strategic direction but also that supportive policies, procedures, guidelines and systems are in place to assist managers to implement the strategy. Succession planning and leadership development are important strategic actions to secure a pipeline of not only appropriate leadership but also future leadership talent. A useful model in helping make sense of the leadership requirements within an organisation and its development is the leadership pipeline model,¹¹³ which describes six leadership passages as managers take on the work of increasing complexity and scope, requiring different leadership skills and values:

1. From managing self to first-line management (managing others)
2. From managing others to managing managers
3. From managing managers to functional manager (managing a function or department)
4. From functional manager to business manager (managing multi-functions)
5. From business manager to group manager
6. From group manager to enterprise manager.

Having designed and implemented appropriate organisational structural subsystems, staffed the organisation and ensured social capital, and established appropriate leadership within the organisation, strategic leaders also need to create an **organisational culture** and influence the **organisational climate** to create an integrated organisation.

12.5.4 Create organisational culture and influence climate

Each organisation has its own unique **organisational culture** or personality that influences the behaviour of individuals in it. Top management needs to accept that as the leaders of the organisation, they act as primary transmitters of organisational culture, and they must be aware of the implications of this role. Creating an organisational culture and values supportive of the strategy is important in building an integrated system to enable the successful implementation of strategy. According to Schein, organisational culture is a collective assessment of an organisation based on the:

*... pattern of shared basic assumptions that the group [has] learned as it [has] solved its problems of external adaptation and internal integration, that has worked well enough to be considered valid and, therefore, to be taught to new members as the correct way to perceive, think, and feel in relation to those problems.*¹¹⁴

Culture simply refers to how things are done in the organisation,¹¹⁵ reflecting the way in which people perform tasks, make decisions, set objectives and manage resources to achieve them.¹¹⁶ Climate, however, although also a collective assessment of the organisation, refers to 'people's collective assessment of an organisation in terms of whether it is a good or bad place to work, whether it is friendly and warm, cold, hard-working, easy-going, and so

forth.¹¹⁷ It relates 'to the prevailing atmosphere surrounding the organisation, to the level of morale, and to the strength of feelings or belonging, care and goodwill among members.'¹¹⁸ Culture is based on deeper, relatively permanent, often unconscious, values, norms and assumptions¹¹⁹ and is more enduring than climate, although both affect the behaviour of organisational members.

In implementing strategy, it is important that strategic leaders analyse the culture of the organisation to determine its appropriateness and to create, manage and sometimes even change the culture.¹²⁰ This implies that the strategic leader needs to be able to understand and work with the culture of the organisation. Culture can be understood from different levels, where levels refer to 'the degree to which the cultural phenomenon is visible to the observer':

- The first or surface level, termed 'artefacts',¹²¹ is the most visible one, although it is the most difficult to make sense of. It represents what one would see, hear and feel when encountering an organisation, such as the architecture of the physical environment, language used, technology, products, clothing, myths, rituals, ceremonies, stories and publications.
- The second level, or the 'espoused values' level,¹²² represents what ought to be, as distinct from what is. These values influence how to deal with new tasks, problems or situations. If the solutions work, the value can become a belief.
- The third level, termed the 'basic underlying assumptions'¹²³ level, is least visible and represents those assumptions that guide behaviour.

See [Chapter 13 section 13.3.8](#) for more on organisational culture.

In creating the integrated organisational system to implement strategy, it was noted earlier that strategic leaders need to fulfil a number of tasks, four of which have been described above. The final task is the one of building, using and growing distinctive organisational capabilities aligned to the strategy.

12.6 Build, use and grow distinctive organisational capabilities aligned to the strategy

The successful implementation of strategy requires that top management mobilise the necessary resources to identify, cultivate and exploit the distinctive existing or new organisational capabilities of the organisation to execute the strategy successfully. **Distinctive capabilities** refer to activities the organisation performs exceptionally well and that may result in a competitive advantage.¹²⁴ Strategic leaders play a key role in understanding what their key resources and capabilities are, and making investments and strategic decisions that will allow them to develop new capabilities for a sustainable future. This implies that strategic leaders should have a good understanding of what their key resources and capabilities are, and what the business environment will require from them now and in future.

Distinctive capabilities are:

- valuable, as they allow the organisation to exploit opportunities, counteract threats and develop competitive advantage
- rare, in that they are not possessed by many other organisations
- costly, or difficult for others to imitate
- non-substitutable, in that there is no direct equivalent.¹²⁵

In addition to the above-mentioned criteria, there are also activities that add value through the value chain.¹²⁶ These include primary activities involved with a product's¹²⁷ physical production, its sale and distribution, and after-sales service, and secondary activities that assist the primary activities. Refer to [Chapter 7](#) for a more detailed discussion on the value chain (section 7.3.3.3).

CASE EXAMPLE: Key competencies of Sasol¹²⁸

- Managing the balance sheet and creating headroom through cost-containment programmes and risk-mitigation initiatives
- Driving innovation in our products and customer service
- Operations excellence in delivering continuous improvement in volumes
- Ability to operate in various environments and geographies, currently 33 countries.

12.7 Ensure ethical practices and good governance

Organisations have a responsibility as a juristic person. Organisational failures and scandals draw attention to organisations not always fulfilling this responsibility with often negative consequences for stakeholders, society and the economy. Ethical practices and good governance play a valuable role in organisations fulfilling their responsibility, performing and being sustainable. It is the responsibility of top management to ensure ethical practices and good governance, but it does start with managers themselves being ethical leaders, as identified earlier.

This is clearly acknowledged by the Clicks Group, as we can see in the Case example below.

CASE EXAMPLE: Contribution of governance at Clicks¹²⁹

The Clicks Group recognises the value of corporate governance in ensuring the sustainability of the business and in enhancing long-term equity performance. The board believes that effective governance is also contributing to value creation in at least the following respects:

- Providing a clearer view of the business through a greater degree of integration between financial and non-financial reporting
- Improving the quality of reporting by management to the board
- Promoting greater transparency and disclosure to stakeholders, including shareholders
- Building consumer confidence in the brands
- Enhancing accountability to shareholders
- Providing equitable performance management and reward structures for employees
- Providing effective leadership and decision-making throughout the business
- Managing and mitigating risk more effectively.

Playing a key role in delivering on this responsibility is top management ensuring ethical practices and good governance. They need to steer and set direction with regard to the way in which specific governance areas are to be approached, addressed and conducted.¹³⁰ To fulfil this role top, managers first need to understand, accept and fulfil their responsibility. This requires them to be familiar with the Companies Act and the King IV Report on Corporate Governance for South Africa, as well as other relevant requirements. Relevant principles and practices to realise the

benefits of good governance need to be responsibly applied and monitored. Ethical practices and good governance, though, are more than simply complying, as is highlighted by the Clicks Group in the Case example below.

CASE EXAMPLE: Going beyond compliance – the Clicks Group¹³¹

While compliance with applicable regulation and voluntary codes is a good baseline from which to measure governance, and a non-negotiable demand by the board, the group's commitment to good governance goes beyond compliance. The group's governance and compliance framework is founded on the principles of accountability, transparency, ethical management and fairness. Sound governance is entrenched across the entire business. Governance processes are regularly reviewed to align with regulatory changes and to reflect best practice. Strong compliance structures and processes to support the effective functioning of these structures are essential to help avoid sanctions for non-compliance with regulation and to contribute to the sustainability of the business. The board accordingly maintains a focus on supporting and, where necessary, enhancing these structures and processes.

Evident also from the Clicks Group is the need for structures and processes. Strategic leaders need to set the example personally by role modelling ethical and effective leadership through their own behaviour, ensuring the creation of a culture of ethics and 'ethical values applied to decision-making, conduct, and the relationship between the organisation, its stakeholders and the broader society'.¹³²

Ethical leadership 'involves the anticipation and prevention, or otherwise amelioration, of the negative consequences of the organisation's activities and outputs on the economy, society and the environment and the capitals that it uses and affects'.¹³³

Strategic leaders need to put frameworks, structures, policy, processes and controls in place to comply with applicable legislation and codes of good practice and so be able to 'ensure accountability for organisational performance by means of, among others, reporting and disclosure'.¹³⁴

The Case example below contains some examples of what strategic leaders at Sasol do to ensure ethical practices and good governance.

CASE EXAMPLE: Ensuring ethical practices and good governance at Sasol¹³⁵

The Board and its committees continue to closely monitor the implementation of Sasol's legal compliance policy and processes and improve upon them, to mitigate the risk of non-compliance with the laws in the various jurisdictions in which we do business. Competition laws, anti-bribery and anti-corruption laws, sanction laws and safety, health and environmental laws, identified as key group legal compliance risk areas, remain our focus. We have implemented risk mitigation controls for each of these areas, aiming to achieve a balanced approach on compliance, by taking into consideration Sasol's obligations as well as Sasol's rights.

We regularly review and benchmark the Group's governance structures and processes to ensure they support effective and ethical leadership, good corporate citizenship and sustainable development and ensure that they are applied in the best interests of Sasol and our stakeholders. We have the necessary policies and processes in place to ensure that all entities in the Sasol Group adhere to essential Group requirements and minimum governance standards. As a direct or indirect shareholder, Sasol exercises its rights and is involved in the decision-making of its subsidiaries on material matters and is satisfied that its delegation of authority framework contributes to role clarity and effective exercise of authority and responsibilities.

It is important to note, however, that ensuring ethical practices and good governance is not a static process and needs to be reviewed and changed.

12.8 Initiate and lead strategic change

By now it is clear that to be sustainable, organisations need to respond to the environment in which they exist. This requires constant change, and often large-scale change. To position their organisations, strategic leaders need to formulate a path, a course of action or game plan (strategy) that needs to be successfully implemented, which requires that they understand organisations and identify, initiate and lead successful change. Upfront, though, strategic leaders need to be aware of their own position with regard to change, and how open and accepting of change they are, as well as knowing their own ability to plan, initiate and lead change. This relates to strategic leaders having ‘adaptive capacity’¹³⁶ and strategic thinking. Another important consideration for strategic leaders, as the change agents, is to consider whether they have the credibility to initiate and manage the change, or whether external change management consultants need to be brought in.

There is no escaping the fact that upfront change needs to be carefully thought through, conceptualised and planned before being initiated and led. Strategic leaders need be aware of and understand why change fails, and incorporate this into their planning and leading of any change. The observation of the change efforts of more than 100 organisations¹³⁷ identified eight fundamental errors in managing change:

- Not establishing a great enough sense of urgency
- Not creating a powerful enough guiding coalition
- Lacking a vision
- Under-communicating the vision
- Not removing obstacles to the vision
- Not systematically planning and creating short-term wins
- Declaring victory too soon
- Not anchoring changes in the organisation’s culture.

When thinking through (conceptualising) and planning the change, managers must pay careful attention to understanding:

- why change is necessary
- the urgency of the change
- the readiness of the organisation for change
- the kind of change and what in the organisation will need to change
- what the desired future state is
- the obstacles to successful change
- the cost of the change and resource requirements.

The strategic leadership responsibility of understanding organisations as a whole is critical to identifying the need for change and formulating an argument as to the urgency of change. Strategic leaders must establish a sense of urgency¹³⁸ as this creates a sense of discomfort or dissatisfaction with the status quo, which encourages a need for change. Visit this article online: The superbrand that reinvented itself. <https://www.theguardian.com/lifeandstyle/2017/jun/04/how-lego-clicked-the-super-brand-that-reinvented-itself>.

After reading the article, consider how the CEO of Lego established a sense of urgency for change.¹³⁹



The argument as to the urgency of change needs to be effectively communicated to influence and convince the organisation and create the conscious need for change. Critical here, and throughout the change process, is leadership – the emotional intelligence and behaviour of strategic leaders (recall [section 12.3](#)).

Not only are understanding organisations as a whole, strategic thinking and leadership critical and important in identifying the need for change and formulating a sense of urgency, but also in determining what to change. The Burke-Litwin model¹⁴⁰ of individual and organisational performance differentiates between the variables associated with two types of change, namely transformational and transactional change:

- Transformational change or second order change is revolutionary, and changes the fundamental nature or culture of the organisation.
- With transactional or first order change, the nature of the organisation remains unaltered.

The model suggests that transformational change is achieved by changing the leadership, mission and strategy, while changes to management practices, structure and systems produce transactional change or change in the climate of the organisation.¹⁴¹ In determining what needs to change to enable the successful implementation of the relevant strategy, models such as the McKinsey 7-S framework and the Higgins' 8-S model (see [Chapter 13](#) for a more detailed discussion of these frameworks) can also assist in identifying the components, variables or elements that potentially need to change. Successful implementation typically requires changes which may relate to the following components:

- *Resources*: their source, quality, quantity, configuration and allocation
- *Structure*: organisational design, allocation of authority, physical setting, policies and procedures
- *Systems and processes*: tasks, work methods and processes, value chain and job design
- *People*: skills, knowledge, beliefs, attitudes, behaviour, social relationships, organisational culture and performance
- *Organisational culture*: the organisational values, the implicit way in which things are done in the organisation
- *Leadership approach and style*: the way in which managers at all levels manage and lead people.

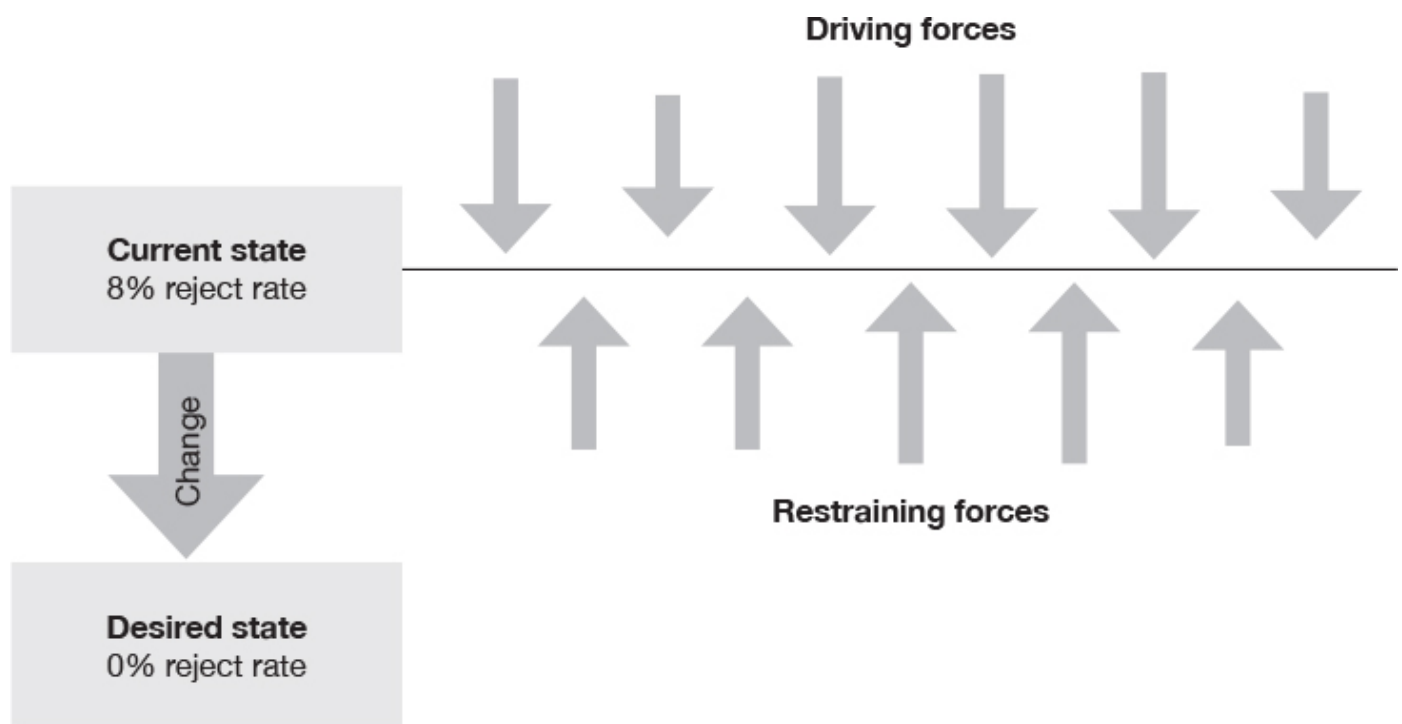
To convince the members of the organisation, together with establishing a sense of urgency, it is important to identify appropriate people to champion the change. These are people who are generally excited about and open to the possibility of change, as well as those who hold sufficient power to constructively influence others to be committed to the change. It is consequently important to identify the type of power being used as the use of coercive power tends to result in resistance. According to Kotter, '[i]n both small and large organisations, a successful guiding coalition team may consist of only three to five people during the first year of a renewal effort. But in big organisations, the coalition needs to grow to the 20–50 range before much progress can be made.'¹⁴² Establishing a coalition team creates a critical mass for change. This can be done by identifying relevant individuals or groups whose support is needed for the success of the change. It is therefore important to identify key stakeholders throughout the organisation that can form part of a coalition that will guide and facilitate the change. 'In every successful transformation effort ... the guiding coalition develops a picture of the future that is relatively easy to communicate and appeals to customers, stockholders, and employees.'¹⁴³

Not only must strategic leaders conceptualise, plan and initiate change, but they also need to lead the change for success. This entails not only convincing the organisation of the need for change but developing and communicating a vision of the desired future. This requires the strategic leadership responsibility of developing and communicating a compelling vision to lead change (section 12.4).

There will, however, be obstacles to the vision. One of these is people, and the fact that no change happens unless people change. Strategic leaders need to anticipate and plan not only for the obstacles but also for the facilitators of the change initiative by conducting a force field analysis. This assists in thinking through and identifying the driving forces supportive of the change, and the restraining factors, i.e. obstacles or forces that work to maintain the status quo. Note, however, that adding new driving forces only increases the resistance.¹⁴⁴ Once the strategic leaders have identified the driving and restraining forces, they can plan for the implementation of the change initiative, keeping in mind the potential obstacles and having plans in place to remove or reduce them.

See Figure 12.2 for an example of a force field analysis. Let us assume that an organisation currently has a rejection rate of 8% on its production line. This is far too high given that a 0% rejection rate is desired. To change the current rejection rate, those initiating the change can conduct a force field analysis to identify the driving and the restraining forces. In the example in Figure 12.2, restraining forces are those factors that prevent or hinder the change from an 8% to a 0% rejection rate. Examples of restraining forces are resistance from staff, faulty machinery, staff lacking the necessary skills, no quality control or poor-quality materials. Driving forces refer to factors that support the change away from the current state, for example new technology, support from top management, and funding availability.

Figure 12.2 Force field analysis



Resistance from people is often one of the restraining forces or obstacles identified during a force field analysis. Change is about moving from a known current situation, the status quo, to a desired unknown future situation. The uncertainty associated with an unknown future situation engenders a response of resistance from individuals and groups of people in an organisation unless there are compelling reasons that convince them otherwise, as argued above. Individuals react to change in a variety of ways, which can be expressed in the form of withdrawal, anxiety, sadness, confusion or anger. Similarly, organisations also remain comfortable with the status quo and also resist change. It is important to understand the source of resistance and to determine strategies to manage it. The implementation of change is crucial and involves the change of the organisation from its existing state to the desired future state. It is important during the transition process to the desired state that resources are committed and allocated to the programme. Here management must pay attention to planning the transition carefully as a project to determine goals and the timing of what needs to be done.

It is also important to consider maintaining momentum along the path to the desired state. Change takes time and can lose momentum if there are no short-term goals to meet and celebrate.¹⁴⁵ In successful changes, 'managers actively look for ways to obtain clear performance improvements ... achieve the objectives, and reward the people involved with recognition, promotions and even money.'¹⁴⁶

New behaviours expected as part of the change effort need to be reinforced by linking the formal performance management and reward systems to the desired behaviours. Appropriate changes to these systems may well have to take place to encourage and support the desired behaviours. It is also important to consider the role of intrinsic rewards in reinforcing the required behaviour and maintaining the momentum necessary for the success of the change initiative. During change programmes, however, 'many managers fail to anticipate the decline in performance, productivity, or satisfaction as change is implemented' and fail to recognise that 'organisation members need time to practise, develop, and learn new behaviours ...'¹⁴⁷

In the final analysis, 'change sticks when it becomes the "way we do things around here", when it seeps into the bloodstream of the corporate body.'¹⁴⁸ It needs to be institutionalised. Strategic leaders should not be too eager to declare the success of change. When institutionalising change, it is important that strategic leaders show the people of the organisation the connections between the new systems, approaches, behaviours and attitudes, and the

performance of the organisation by communicating consciously within the organisation and making the effort to ensure that 'top management really does personify the new approach'.¹⁴⁹



With any change initiatives, strategic leaders need to monitor and evaluate the change process and ensure the availability of resources to support the initiatives. They need to decide on the allocation of resources within the organisation to enable the implementation of strategy. Particular strategies may require, for example, that resources be directed to research and development (R&D); the purchase of specialised software or resources to pay a premium to attract people with specialised skills; shifting manufacturing capacity or directing resources to R&D (e.g. when an automotive assembly plant changes from hybrid to electric cars); or investing in a drive to ensure productivity improvements.

12.9 Summary

For organisations to succeed and be sustainable, strategy needs to be successfully implemented. It is top-level managers who are ultimately responsible for the leadership of the organisation as a whole and play a key

determining role in the successful implementation of strategy. They must take the lead in implementing strategy but need the assistance of managers throughout the organisation as well as committed, performing staff.

To implement strategy successfully, top-level managers must lead strategically. To be effective, strategic leaders fulfil a number of responsibilities:

- *Understand the organisation as a whole:* The strategic leader makes sense of the organisation as a whole and so identifies what actions to take to enable it to implement strategy successfully.
- *Lead effectively and ethically for strategic results:* Strategic leaders are emotionally intelligent and achieve results by applying a range of behaviours wisely, acknowledging that the feasibility of their style depends on the cultural conditioning of subordinates.
- *Develop and communicate a compelling vision to lead change:* Strategic leaders lead the implementation of strategy. They get the ball rolling by influencing the entire staff complement of the organisation by providing direction through vision and the setting of performance measures.
- *Create an integrated organisational system supportive of the strategy:* Strategic leaders align the variety of different interacting components of an organisation as a unified whole to enable it to implement strategy successfully. In creating the integrated system, top managers fulfil the following tasks:
 - » *Design and implement appropriate organisational structure:* Structure and supportive mechanisms in the form of systems, processes and policies are set in place to support and bring out the appropriate human behaviour to facilitate the actions required to implement the strategy.
 - » *Staff the organisation and ensure social capital:* The right people with the right skills are available at the right time to work actively towards executing the particular strategy of the organisation.
 - » *Ensure appropriate leadership within the organisation:* Strategic leaders need other managers throughout the organisation to ensure appropriate leadership within the organisation at the various levels to understand, interpret and translate strategy into everyday actions to be performed by the staff of the organisation.
 - » *Create organisational culture and influence climate:* Culture and values supportive of the strategy are created and the climate of the organisation influenced to support the strategy.
- *Build and use distinctive organisational capabilities aligned to the strategy:* Strategic leaders identify existing and new organisational capabilities required by the strategy, and ensure that these are developed and delivered by the organisation as a whole to implement strategy.
- *Ensure ethical practices and good governance:* The example is personally set by strategic leaders through ethical leadership by role modelling ethical behaviour. The King IV Report on Corporate Governance with its principles and practices is key to strategic leaders' responsibility in leading and directing the way in which specific governance areas are to be approached. Relevant structures, policies, processes and controls to guide and monitor ethical behaviour and governance, together with an ethical culture and supportive organisational values, are set.
- *Initiate and manage change:* Organisations evolve. They need to adapt to their environment, and their strategies change. This inevitably requires change in the organisation, which is the responsibility of strategic leaders to initiate and lead. The effective initiation and management of change can determine whether or not the required actions to implement the strategy succeed.

REFLECTION BOX:

Are South African organisations adopting the concept of ubuntu in their strategic leadership strategies or are they sticking to the Western style of management? What will work best?

Opening case study questions

1. Discuss strategic leadership as a concept and how AutoTrader may have benefited from the strategic leadership of their CEO, George Mienie.
2. How would you classify George Mienie's strategic leadership style on the basis of evidence provided in the Opening case study?

Discussion questions

1. Explain why strategic leadership is a key factor in successfully implementing strategy.
2. With reference to key responsibilities, advise on what makes for effective strategic leadership.
3. Explain what strategic thinking entails. Include in your explanation the role of models in strategic thinking, and how strategic leaders can utilise them to assist in the implementation of strategy.
4. Discuss the meaning of emotional intelligence. Use specific examples of which you are aware to help describe emotional intelligence in practice. Explain why emotional intelligence is important for effective strategic leadership
5. Advise on what a manager can do to develop emotional intelligence. Identify and explain what you can do to develop your emotional intelligence.
6. Critically evaluate the contribution of the concept of ubuntu to our understanding of effective leadership in the successful implementation of strategy in a South African context.
7. Advise on what a strategic leader needs to do to ensure effective change management.

Using knowledge and skills

1. Access the Annual Integrated Report of three organisations such as Barloworld, Clicks Group Limited, the Foschini Group, Lewis Group Ltd, Murray & Roberts, Old Mutual plc, Sanlam Group, Sasol Limited, Shoprite Holdings Ltd, WBHO and Woolworths Holdings Limited, to name a few. Compare and contrast the contents of these reports and comment on the areas organisations are typically reporting on.
 - Comment on evidence of the organisations having strategic direction.
 - Where relevant, using the evidence, describe and explain the strategic direction of each company.
 - Compare and contrast their business models.
 - Comment on how top management of these companies oversees and monitors implementation and execution of the strategy.
 - Explain and describe the evidence of accountability for organisational performance by means of reporting and disclosure.
 - Comment on how the organisations are doing in terms of performance and on the link between performance indicators, vision, strategy and strategic goals/objectives.
 - Describe what you think happens 'behind the scenes' from a management perspective for these organisations to do what they do and perform as they do.
2. Prepare a PowerPoint slideshow presentation of 15 slides for the top management team of a business. The presentation needs to highlight the responsibility of the top management team in ensuring the success of the business.
3. Draw a diagram that represents how an organisation works. Critically evaluate the validity and practical value of your model in guiding strategic leaders in successfully implementing strategy.
4. Identify a company. Visit https://www.mindtools.com/pages/article/newSTR_95.htm for the Nadler and Tushman Congruence Model to develop your knowledge and understanding of this model and how to apply it.

Using the model as a guide, describe the inputs, history and strategy of the company. Analyse and describe the four components (task, formal organisational arrangements, informal organisation, individual) of the organisation, and evaluate the degree of fit or congruence between the various components as described by the model. Describe the effectiveness of the organisation in terms of its output. Propose any changes required to the organisation to improve the degree of fit and/or its effectiveness.

5. You plan to improve your marks at university. Conduct a force field analysis identifying the relevant driving and restraining forces, and make recommendations on what you can do to improve your marks.
6. Identify what you need to do to develop your effectiveness as a strategic leader. Draft a strategy with strategic objectives, and explain how you plan to implement it.

Further reading

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- Van den Berg, G. & Pietersma, P. 2014. *Key management models: The 75+ models every manager needs to know*, 3rd ed. Indianapolis, Indiana: FT Press Financial Times.

Suggested websites

- King IV Report on Corporate Governance. https://c.ymcdn.com/sites/iodsa.site-ym.com/resource/collection/684B68A7-B768-465C-8214-E3A007F15A5A/IODSA_King_IV_Report_-_WebVersion.pdf
- Top Employers South Africa. <https://www.top-employers.com/en-ZA/certified-top-employers/country/south-africa/>
- Institute of Directors Southern Africa. www.iodsa.co.za
- Entrepreneur Magazine. www.entrepreneurmag.co.za
- Leadership Platform. www.leadershipplatform.com

Leadership Magazine. <http://www.leadershiponline.co.za/>. Access 'articles'.

Leader.co.za. <http://www.leader.co.za/>

How Lego clicked: The superbrand that reinvented itself.

<https://www.theguardian.com/lifeandstyle/2017/jun/04/how-lego-clicked-the-super-brand-that-reinvented-itself>

The De Bono Group. www.debonogroup.com/serious-creativity.php. Read an article, 'Serious creativity', by Edward de Bono. Also access hbr.org/2016/09/how-senior-executives-find-time-to-be-creative

Ethics Institute of South Africa. www.tei.org.za

MindTools. <https://www.mindtools.com/>. Explore the toolkit for a range of different management and leadership skills and go to more resources for videos. Toolkit examples include:

- Leadership skills: https://www.mindtools.com/pages/main/newMN_LDR.htm
- Strategy tools: https://www.mindtools.com/pages/main/newMN_STR.htm
- Problem solving: https://www.mindtools.com/pages/main/newMN_TMC.htm
- Decision-making: https://www.mindtools.com/pages/main/newMN_TED.htm
- Project management: https://www.mindtools.com/pages/main/newMN_PPM.htm
- Communication skills: https://www.mindtools.com/pages/main/communication_skills.htm
- Creativity tools: https://www.mindtools.com/pages/main/newMN_CT.htm

For specific tools access:

- The Nadler and Tushman Congruence Model. https://www.mindtools.com/pages/article/newSTR_95.htm
- For leadership forms of power: https://www.mindtools.com/pages/article/newLDR_56.htm

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CHAPTER 13

Organisational alignment and strategy implementation through organisational architecture

Robert Venter

LEARNING OUTCOMES

After reading this chapter, you should be able to:

- define and describe organisational architecture
- understand the role of organisational architecture in strategic alignment
- describe different types of organisational architecture
- explain organisational architecture according to the Lee et al. framework
- apply the Lee et al. organisational architecture.

KEY TERMS

alignment
functional strategy
knowledge, skills and abilities (KSAs)
organisational architecture
organisational processes
paradigm
structure/systems

OPENING CASE STUDY



Want to build an organisation that lasts? Create a superorganism¹

Tamsin Woolley-Barker

For the past 25 years, I've studied everything from baboon cooperation in Ethiopia and orca whale innovation in the Bering Sea, to the Argentine ant invasion in my kitchen, and my colleagues at work (not nearly as interesting!), all through an evolutionary lens.

Today, I use that lens to help companies evolve.

I'm a Biomimicry Professional, and a Biologist at the Design Table, and the teams I work with develop biologically-inspired solutions for a Global 500 clientele. We search for the technologies that make life – and business – go.

As an evolutionary biologist, a businessperson, and a biomimic, I'm always looking for the deep patterns in life, trying to find out what lasts. And here's one thing I know is true:

Organisations can't keep growing the way we structure them today.

Like dinosaurs, organisations keep getting bigger, but they need huge bones to support the weight of all that complexity. The more weight, the more bones; the more bones, the more weight. It's a catch-22 situation. Management is the ponderous skeleton that keeps organisations from collapse. But as they grow, the costs of management rise, and the ability to adapt declines. When sudden change comes, there's not much a company can do – it's a sitting duck (or dinosaur) for the next cosmic collision. Hierarchies can only scale so much – we can't grow bigger bones forever.

There's nothing inherently wrong with hierarchies. In fact, nature uses them all the time to stop change from happening. Scientists tell us that cells go rogue in our bodies every day, but a hierarchical system usually stops those cancers from growing. Hierarchies are important and useful. But they aren't the right structures for adapting to change, and they inherently limit growth.

Change is coming – with shifting supply chains and customer needs, upstart competitors and technologies, resource scarcity and volatile prices, change is sudden, unexpected, and potentially calamitous. Multinationals span many divisions and fractured market segments, their teams cross cultures, languages, time zones, and governments. All of it is held together by management. Between technological advances and social revolutions, climate change and peak everything, companies inhabit an unpredictable world of their own making. They are bound to topple and fall. Meanwhile, they have a mandate to maximize shareholder return. Companies that are beholden to this short-sighted maxim require infinite growth. What happens when they hit the limit? Something has to give.

As an evolutionary biologist, I find myself asking—who inherited the Earth in the dinosaurs' place?

Tiny, nimble mammals for one. Those ancient furtive furballs diversified into everything from elephant shrews to platypi, blue whales to rhinoceros. One of those lucky species is us—and look at us now! Our societies are everywhere, transforming everything we touch.

But other creatures survived the crash as well. Hard-working teams of ants and termites built wealth alongside the dinosaurs, and are building it still. Termite colonies have chewed for 250 million years, to our lasting dismay, and ants have marched from their nests for 150 million. The great biologist E.O. Wilson

estimates that all those ants tied in a sack would weigh about as much as all of us humans combined. The global mass of termites is about 27 times that – a cow's worth of them for every one of us.

But there are more. Beneath the soil you walk on, no matter where you live, lies a very ancient and even more successful society. A half-billion year old pulsing nutrient superhighway of fungus toils away in the ground, constantly searching for molecules of matter to digest, minerals and water to absorb. Whatever these individuals find flows through the system, because the fungi are fused into one. Everyone gets more than they would on their own. We like to call this the 'wood wide web,' a phrase coined by Professor Suzanne Simard (watch her extraordinary TED Ed).

All these creatures are 'superorganisms' – by which I mean 'groups of genetically distinct individuals of the same species, with specialized division of labor, where one individual can't survive alone for very long.' Their colonies comprise millions of diverse individuals, but together they accomplish the same kinds of tasks a single organism does, with far less processing power.

They are far more than one ordinary being. Superorganisms have a special knack for creating abundance within the kinds of landscapes of scarcity that typically exclude other creatures. You'll find ants thriving in the deserts of Australia, and termites in parched Namibia. Naked mole rats push dirt around Somalia as we speak, and honeybees stay warm through bitter winter freezes as low as -30°C (-22°F). How do they do it?

They leverage the power of collective intelligence and collaborative innovation. Together, they gather tiny, scattered, squandered scraps that aren't worth the effort for other animals—splinters of wood, bits of chopped up leaves, specks of pollen, molecules of water, and fertilizer.

'Superorganisms have a special knack for creating abundance within the kinds of landscapes of scarcity that typically exclude other creatures.'

We can think of these colonies as living, breathing patches of network, constantly shifting into new structures as the environment changes. Where the soil is rich in nutrients, they maximize their exposure to absorb as much as they can. Where nutrients are poor, they hurry on, pushing for new ground as fast as they can. Their networks crisscross and connect in dense webs, shuttling resources wherever they are needed. With no commander, they organize themselves into a 'beautifully open-ended, indeterminate dynamic structure that continually responds to changing demands' according to British mycologist Alan Rayner.

Isn't that exactly what we want in business? It's such a great idea, we've evolved a networked communication system for ourselves! It took the fungi 500 million years to evolve their 'internet,' but we did it in 50 – and theirs isn't even global! But before we pat ourselves on the back, we better learn how to use it. We need a new way to think about leading, managing, and responding to change, and our remarkable invention is the key. But utilizing these resources correctly requires a massive change in the way we do business. Chemists call this a 'phase shift' – like water moving from steam to a liquid to ice. The content is the same, but the form is so radically different you'd never even recognize it as the same stuff. That is what we are attempting to do – a phase shift.

Superorganisms, like ants and fungi, have been networked for a very long time. They know what they're doing. How do they capitalize on opportunity, survive disturbance, and stay resilient? How do they spark innovation, nurture collaboration, and lead their teams? How do they seed the present for lasting – and growing – returns on investment for the next generation? What is their secret?

For one thing, they build their compounding wealth on infinite things – sunlight and sugars, for example, and the complexity, diversity, and interconnectedness of networks. They grow from the edges out, adding modular, self-managed units that seek and respond to opportunity and threat on the front lines. Team performance emerges in real-time, like a constantly updated film-reel of snapshots built from thousands of pixels. Superorganisms break large, complex problems into tiny bites of action, building until tipping points are reached and change is triggered. There are no forecasts, budgets, meetings, or plans. There is no boss. Strategy happens organically, all the time, everywhere, and decisions are frequent, small, and imperfect. This is how superorganisms adapt to change – at the edges, all the time, in little bits of work done by everyone.

We've found termite mounds in the Congo that have been occupied continuously for two millennia, and a humongous fungus in Oregon is over 2 400 years old. These superorganisms are as close to immortal as any living thing, and their ancient way of life is a recipe for unbounded value and lasting success.



The oldest organism in the world: fungal network in the Malheur National Forest, Oregon.

Even better – the value they create spills out into the larger ecosystem, feeding the life that feeds them. That is how their wealth compounds. Trees convert sunlight, water, and carbon dioxide into sugars – the fungus can't do that. Instead, vast numbers of fused individuals absorb bits of nitrogen, phosphorus, and water, and bring them to the tree, trading it for sugar. Hundreds of millions of years ago, the earliest land plants had only the feeblest roots. But they intertwined with the fungi and grew strong. Today, green plants carpet the land, feeding us all, and the fungi most of all.

Similarly, the mound-dwelling African termites collect scraps of wood and bits of grass. By concentrating energy and nutrients and unlocking their value, these mounds become hotspots, nurturing all kinds of life. The grass is better, and draws grazing herbivores who feed hungry carnivores and fertilize the soil with their dung. More vegetation grows, attracting more prey, more predators, and feeding more termites. It's regenerative capitalism at its best.

These ancient beings offer us a new way of doing business, as we do the hard work of adapting to the reality of a finite Earth. Ants are not choking on smog or stuck in traffic, fungi aren't counting carbon credits or worrying about the Great Pacific Garbage Patch. Termites don't have slums. But all of them grow and prosper, building infinite wealth from infinite stuff.

We can do it too. We just need to study what lasts and why.

If you want your company to change and grow, nimbly and continuously, without that slow and costly layer of management, what you need is a living thing.

What you need to build is a superorganism.

Overview

Organisational architecture as a strategic tool has grown in popularity over the past decade, particularly because of its value in aligning the organisation to ensure strategic attainability. Organisational architecture is an integrated strategic response that draws together key dimensions of the organisation, such as organisational structure, leadership, organisational culture, policies and strategies, to guide strategy formulation, alignment and implementation. Organisational architecture thus provides a blueprint of the internal and largely invisible workings of the organisation.² It is precisely this blueprint that serves as an indispensable tool, and allows leaders to align core aspects of their organisations with their strategy, thus attaining more effective implementation. This chapter will explore the notions of alignment and implementation with particular reference to the architecture developed by Lee et al.

13.1 Introduction

Formulating an effective strategy is only half the battle won because without effective implementation of the strategy, all good strategic intentions effectively come to nought. The ability of an organisation to facilitate the effective and efficient implementation of strategy is almost entirely dependent on its internal functioning. It is the internal organisation that comprises those elements pivotal in translating the strategy into tangible outcomes and actions. In essence, it is the internal organisation, a largely abstract concept, that describes and delineates how things are done, and who does what. Strategies are put into action and results delivered by means of alignment between organisational culture, policies and procedures, an effective knowledge and skills base, a suitable organisational structure, and different processes and systems.

The emphasis here is on strategic alignment. **Strategic alignment** is quite simply taken to mean that key internal strategic drivers of an organisation work in tandem to ensure effective strategic implementation. Indeed, effective and efficient strategic implementation is not so much dependent on the various components of the internal organisation being in place as it is on these components acting together. In other words, while organisations might well have the necessary internal capabilities to deliver a strong strategy, unless these are aligned it is doubtful whether implementation of the strategy will produce the desired results. The Opening case study alludes to this by using the natural world and the notion of the 'superorganism' as a metaphor for how organisations need to structure or potentially restructure around the principles of symbiosis that are ever-present in the natural world.

In much the same way, organisational architecture provides a useful tool to mesh the internal organisation together by drawing together key dimensions in a cohesive and concerted effort to ensure productive strategic implementation.

Using the architecture developed by Lee et al.,³ this chapter will examine the importance of organisational architecture in aligning the internal organisation. We will explore and analyse each of the key dimensions of the architecture, and highlight the interdependencies.

13.2 What is organisational architecture?

Various authors have helped contribute to an understanding of what organisational architecture is. Table 13.1 sets out some of the key definitions.

Table 13.1 Definitions of organisational architecture

The underlying model of the organisation's way of doing business ⁴
... a model of the enterprise that can be shared by everyone involved in management change ⁵
... all of the various systems, structures, management processes, technologies, strategies etc that make up the modus operandi of the organisation ⁶
... a holistic, future facing, logical blueprint [that] needs to interpret business strategy and provide a focus on customer value, while concurrently identifying the work activities, roles, and competencies, business rules and processes necessary to build and operate the business ⁷
A collectively agreed and communicated document that, in light of the strategic competencies needed to fulfil stakeholder needs, defines and details the major building blocks of the organisation ⁸

- Several key characteristics of a sound organisational architecture are discernible. An organisational architecture should:
- be contained in a formal document that clarifies what the business is about. This, in turn, facilitates strategic formulation and implementation, and the monitoring of strategic progress, since everyone is essentially working towards the same goal.
 - contain specific reference to the key strategic drivers of the organisation
 - relate each pillar of the organisational architecture to the organisation itself, thus creating a blueprint that is unique and specific to that particular organisation (for instance, while policies and processes are key features of almost all architectures, no two organisations will define these pillars in the same way)

- be collectively agreed on by all constituencies in the organisation to attain maximum strategic impact. It stands to reason that because the document sets out what the business is ultimately about, there should be widespread consultation to generate support and consensus. Ultimately, therefore, the organisation should communicate the document as widely as possible and should solicit as many viewpoints as possible. If there is no agreement, then the organisation will not achieve the desired buy-in.

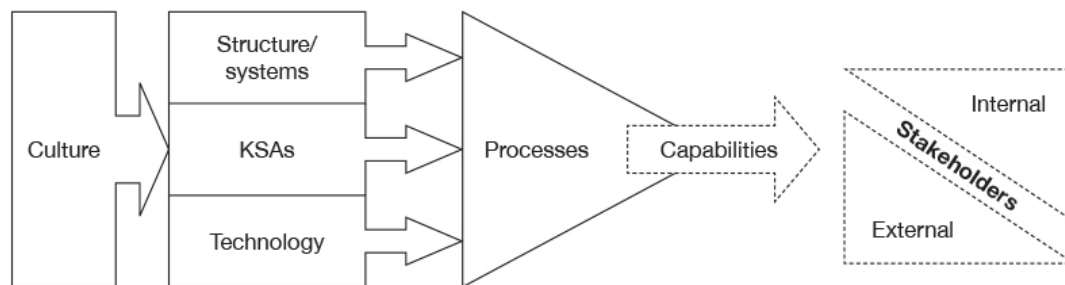
13.3 The ‘shape’ of organisational architectures

Most of the more popular organisational architectures focus on similar key pillars. Table 13.2 describes the first-level or fundamental components of these organisational architectures. As mentioned above, while these pillars serve as a basic framework, each pillar is tailored to each specific organisation by means of deeper application. The Case example *HIV/Aids and organisational architecture: An application* below provides an example of an application of an organisational architecture.

Of the various architectures described above, the McKinsey 7-S framework is arguably the best known because of its widespread popularisation through the consulting organisation that developed it. One of the more recent architectures to emerge is V2MOM. Developed by [Salesforce.com](https://www.salesforce.com)’s CEO, Mark Benioff, this framework is used to focus the organisation on that which ‘really matters.’⁹ At the same time, Nihilent’s MC3 framework has been used extensively in South Africa to support alignment in companies such as SARS, Sasol, MTN, South African Airways, MultiChoice and Nedbank.

However, in our view, it is the architecture of Lee et al. that provides the most nuanced and recent attempt to integrate the various architectures into a cohesive framework. Figure 13.1 illustrates the architecture as a flow diagram that highlights the various interrelationships between the key pillars.

Figure 13.1 Lee et al.’s organisational architecture¹⁰



In terms of the architecture, which is best read in reverse from right to left, organisational capabilities (or important outcomes provided by the organisation – see Chapter 7 for a more detailed discussion of organisational capabilities) are distributed to the various stakeholders through the different **organisational processes**. The **structure/systems, knowledge, skills and abilities (KSA)**, and technology specific to each organisation shape these processes, which are all in turn underscored by organisational culture. Before we discuss these pillars in more detail, the Case example *HIV/Aids and organisational architecture: An application* describes how this architecture might work in practice.

Table 13.2 Basic components of different organisational architectures

Ulrich ¹¹	McKinsey 7-S ¹²	Higgins’ 8-S model ¹³	Nihilent’s MC3 framework ¹⁴	Jay Galbraith’s star framework ¹⁵	Veasey ¹⁶	Wolfenden and Welch ¹⁷	Lee et al. ¹⁸	V2MOM ¹⁹
• Shared mindset • Competence • Consequence (rewards and incentives) • Governance (structure, communications systems, and policies) • Capacity for change • Leadership	• Strategy • Style • Skills • Shared values • Structure • Systems • Staff	• Strategy and purposes • Structure • Systems and processes • Style (leadership/management style) • Processes • (re)Sources • Shared values • Strategic performance	• Calibration • Motivation • Capability • Capacity	• Strategy • Structure • Rewards • Processes • People	• Processes • Organisation technology • Competencies • Culture • Stakeholders and capabilities (inputs)	• Customer segmentation • Customer life cycle interaction (total cycle of value-adding outcomes experience) • Activities (all activities including the life cycle interaction is defined) • Roles • Coordination activity • Business rules (underling organisational culture) • Business processes	• Culture • Structure/systems • Knowledge, skills, and abilities • Technology • Processes • Internal and external stakeholder capabilities	• Vision • Values • Methods • Obstacles • Measures

Table 13.3 An application of the Lee et al. model to HIV/Aids and organisational architecture

Stakeholder analysis (Who are the various stakeholders?)	Capabilities (Various outcomes delivered to stakeholders by the organisation)	Processes (Needed to deliver capabilities)	Knowledge, skills, and attitudes (Initiate and drive processes)	Structure and systems (Initiate and drive processes)	Technology (Initiates and drives processes)	Culture (Informs all other aspects of the architecture)
- Employees » Non-infected employees who are affected » Unaffected employees - Shareholders - Customers or clients - Suppliers or producers - Community - Government	- Employees - Non-discriminatory policy - Education (prevention and awareness) - Voluntary counselling and testing (VCT) - Care, support, and treatment » Extension of benefits to dependents - Safe working environment - Peer education - Shareholders - Disclosure of all information (including prevalence rates, interventions, and cost implications)	- Support processes (including specific processes relating to VCT, treatment, etc.) - Impact on core processes – possible interventions » Flexitime and redeployment to accommodate absenteeism among infected employees » Multiskilling of uninfected and unaffected employees as well as job rotation to counter absenteeism due to sickness and family responsibility	- Base level KSAs » Must have for all members of an organisation » Basic knowledge and awareness of HIV/Aids - Specific programme KSAs » Required for support programmes such as VCT peer counselling, etc. » Properly trained and educated counsellors, nursing staff, psychologists, etc. » Support programmes and specific KSAs can be outsourced	- Formal bodies and positions to deal with the management of the HIV/Aids strategy » Task teams » Committees » Allocation of responsibility to a senior manager - Reporting relationships between formal bodies and positions in terms of the organogram - Establishment of HIV/Aids specific units in the organisation (and concomitant integration in the formal organisational structure) » VCT unit	- Programme-specific technologies (treatment facilities, nursing staff, antiretroviral therapies, etc.) - Technology as a substitute for labour where and if feasible	- Singularly important – can energise action, destigmatise and demystify HIV/Aids - Encourage a culture that is open, transparent, tolerant, based on trust and indeed, embracing of 'otherness' - Positively impact and develop employee attitudes towards HIV/Aids » Sensitivity and awareness training » Diversity management programmes » Use of HIV-positive employees as peer educators and role models
	- Customers or clients - o Better product offerings (for instance, better medical aid and health care provisions) - Suppliers or producers » Joint value-chain approach, and long-term relational contracting with a specific supplier/producer in which resources are shared to devise better awareness campaigns, etc.	- Integration of HIV/Aids interventions into production schedules and deadlines (to ensure minimal stoppages) - Redesigning workflow and procedures (to ensure safety of employees and customers/clients as well as to ensure minimal breakdowns and stoppages) » Redeployment of infected employees » Development of new techniques in manufacturing/service delivery	- Operational KSAs » Job-specific training to accommodate multiskilling and job rotation » Effective knowledge management systems to minimise loss of intellectual capital through turnover » Basic knowledge and awareness of HIV/Aids » Encouragement of innovation among and feedback from employees to come up with better and improved processes	- Health and wellness unit - Treatment facilities - Substitute for leadership (where leadership and senior management are particularly vulnerable) - Flatter organisational structures with greater devolution or responsibility - Impact on job design » Multiskilling, job enlargement, and job enrichment for uninfected employees » Reasonable accommodations for infected employees (redeployment, flexitime, use of devices to assist)		- Engender managerial commitment to and proactive leadership around HIV/Aids policies and procedures in the organisation - Use language positively and appropriately to communicate the 'right' message, as well as a positive approach to dealing with HIV/Aids - Integrate culture into formal contracts of employment through clauses pertaining to contractual security for HIV/Aids sufferers, non-discriminatory policy statements, etc.

Stakeholder analysis (Who are the various stakeholders?)	Capabilities (Various outcomes delivered to stakeholders by the organisation)	Processes (Needed to deliver capabilities)	Knowledge, skills, and attitudes (Initiate and drive processes)	Structure and systems (Initiate and drive processes)	Technology (Initiates and drives processes)	Culture (Informs all other aspects of the architecture)
	- Community » Targeted corporate social investment expenditure focusing on awareness, treatment, and support - Government » Specific reporting	- New approaches to management (emphasis on monitoring and evaluation as well as reporting) - Accommodation of suppliers/producers » Need for alternative, more flexible supply-chain strategies, and dedicated relationships » Stockpiling	Management-specific training in soft skills (increased sensitivity and empathy) as well as in monitoring and evaluation of policies and programmes			- Ensure that resentment from uninfected individuals is kept to a minimum through, e.g., peer education which might create a more tolerant and destigmatised environment - Promote culture through rewards and benefits (such as free or subsidised antiretroviral therapy)

CASE EXAMPLE: HIV/Aids and organisational architecture: An application

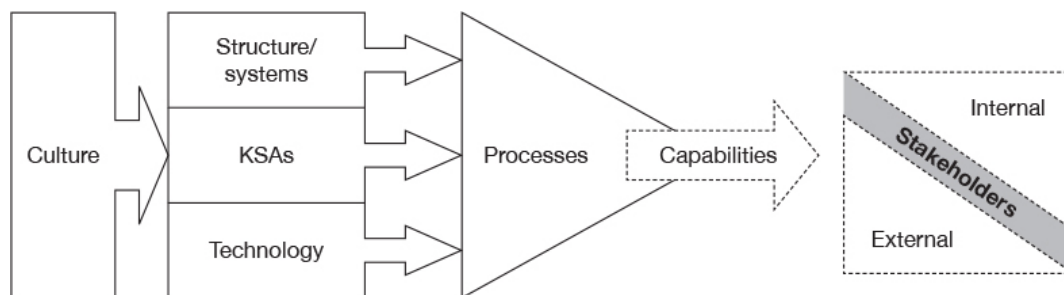
HIV/Aids continues to remain one of the most critical issues affecting South African organisations. It was estimated that in 2017 some 36.9 million individuals were infected worldwide, with 19.6 million adults and children living with HIV in eastern and southern Africa (some 53% of the total number of those infected).²⁰ According to UNAIDS, South Africa experiences the largest HIV epidemic in the world, and accounts for some 19% of the global number of people living with HIV, 15% of new infections and 11% of AIDS-related deaths.²¹

Arguably, the hardest hit group is the economically active segment of the population. This has multiple ramifications for organisations that face rising health-care costs, lost productivity due to increased absenteeism and premature death, psychological and behavioural considerations, as well as legal and ethical considerations.²² Because of this, organisations need to consider targeted and integrated responses that are strategic in nature.

To this end, Lee et al. proposed and applied an organisational architecture to 'instil strategic and integrative integrity into HIV/Aids policies and programmes'.²³ Accordingly, their model is applied in a systemic and cohesive manner to the management and integration of HIV/Aids policy and practise in the organisation. Table 13.3 summarises their approach.

13.3.1 Stakeholders

Figure 13.2 Lee et al.'s organisational architecture



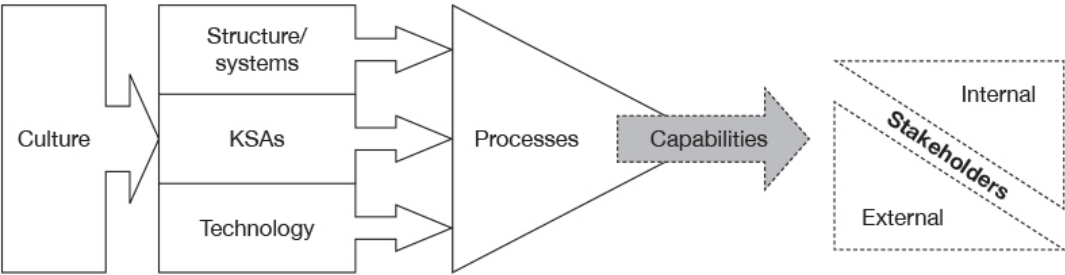
The stakeholders of an organisation are broadly defined as 'any group or individual who can affect or is affected by the achievement of an organization's objectives'.²⁴ Chapter 2, section 2.5 discussed stakeholders in more detail. However, it is nonetheless important to describe them in relation to Lee et al.'s model of organisational architecture.

The various stakeholders of an organisation are both internal and external to the organisation. Moreover, stakeholders may be classified as primary or secondary depending on the overall strategic thrust, and are thus allocated resources accordingly. For instance, should an organisation choose to follow a total quality improvement strategy that seeks to increase customer satisfaction through the commitment of all players in the organisation, then:

- shareholders (primary) should hopefully enjoy higher returns on their investment through increased wealth
- employees (primary) would enjoy greater job autonomy as well as skills and knowledge empowerment
- customers (primary) would enjoy better products or services
- suppliers (secondary) would enjoy better contracts based on symbiotic relationships with the organisation
- the community at large (secondary) would enjoy the benefits of a more responsive organisation that provides better, more socially responsive products or services, as well as increased job opportunities.

13.3.2 Capabilities

Figure 13.3 Lee et al.'s organisational architecture



For the purposes of Lee et al.'s model, capabilities are those deliverables that the organisation provides to stakeholders. Again, these deliverables are variable. They are also entirely dependent on the nature of the strategy adopted and the organisation. Larger organisations with more resources are in a better position to deliver various capabilities (see [Chapters 1 and 7](#) for a more detailed discussion on organisational capabilities). [Table 13.4](#) compares the capabilities underlying cost leadership and differentiation strategies to illustrate the role of capabilities. We have described here the capabilities for each category in broad strokes in terms of outcomes, but they can be translated into more concrete outcomes as done in the Case example *HIV/Aids and organisational architecture: An application*.

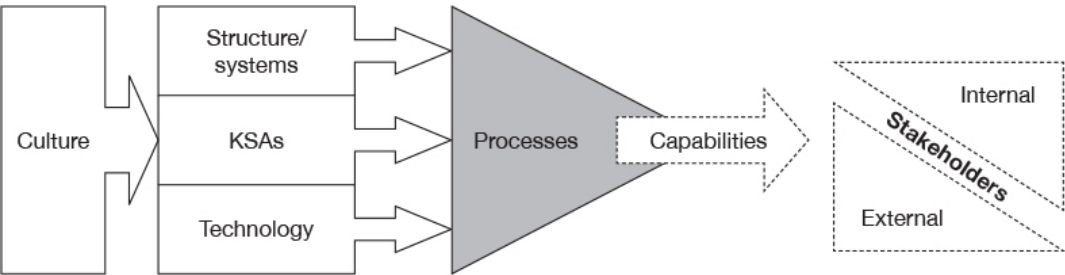
Table 13.4 Capabilities delivered to stakeholders according to competitive strategy²⁵

	Capabilities delivered	
Stakeholders	Cost leadership	Differentiation
Shareholders	Higher returns through streamlined, more cost-effective operations	Higher returns through diversified product or service offerings
Employees	More rigid, Fordist approach to production with high degrees of specialisation and atypical work structures, as well as a focus on lower wages	Stronger focus on autonomy and team work, with high-end skilling involved
Customers	Low priced goods or services that are economical, yet represent value for money	Wider range of differentiated products or services with a focus on innovation
Suppliers	Continuously renegotiated contracts, with an emphasis on price and value	Joint ventures with high-end suppliers committed to innovation and quality
Community	A commitment to maintaining a good public image through, at the very least, complying with relevant legislation	Proactive initiatives to respond to the needs of the broader community at large through active social investment in targeted programmes

Niche and combination strategies will naturally draw on elements from both sets of capabilities, depending on the strategic focus.

13.3.3 Processes

Figure 13.4 Lee et al.'s organisational architecture



Processes are central to the organisational architecture and are instrumental in delivering the capabilities. We can categorise processes according to management, operational and support processes.²⁶

13.3.3.1 Management processes

Management processes encapsulate the basic management tasks of planning, organising, leading, and controlling strategic efforts. We can add the following to the basic tasks:²⁷

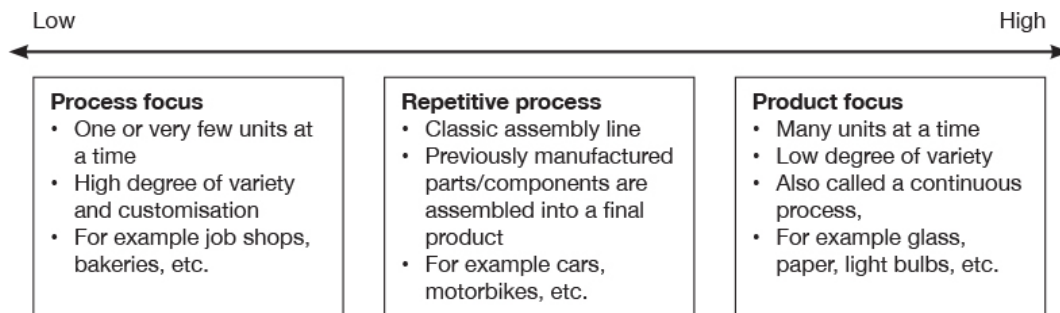
- *Work methods:* Approaches adopted by management to get the job done
- *Roles:* The various responsibilities associated with a job
- *Work agenda:* What goals and tasks the manager intends to achieve
- *Knowledge, skills and levels of performance* required by a job.

In terms of this approach, the manager's work agenda informs the work methods and roles deployed. These in turn feed into and inform the traditional management tasks, resulting in delivery of capabilities (performance). Of course, delivery is further moderated by the manager's skills and knowledge.

13.3.3.2 Operational processes

Operational processes are responsible for the production of an organisation's goods and services through the conversion of inputs into outputs. As such, organisations produce most goods or services by using one of three strategies, namely process focus, repetitive and product focus.²⁸ We can view these three strategies as falling along a continuum, with process focus and product focus falling on either output extreme, as depicted in Figure 13.5.

Figure 13.5 Description of the three operations process strategies²⁹

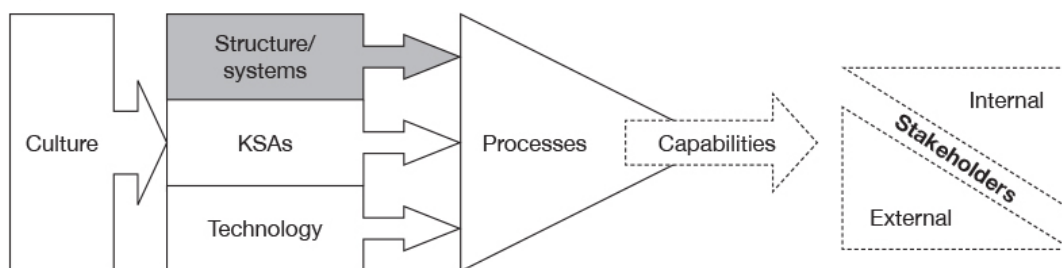


13.3.3.3 Support processes

Support processes are those functions that provide backing for the core business of an organisation. They include human resource management, marketing and information systems (unless, of course, these functions are the core business). Such functions, while ostensibly being on the periphery of the organisation, are key to ensuring its ongoing functionality by ensuring the effective and efficient running of the organisation. Section 13.3.4.2 below elaborates on support processes in the discussion on functional strategies.

13.3.4 Organisational structure

Figure 13.6 Lee et al.'s organisational architecture



The combination of an organisation's structure, the various operational systems it deploys, the key knowledge, skills and attitudes of its staff and the technology used, drives the various processes discussed above. We will first consider organisational structure. In so doing, we will explore what structure is and how different paradigms inform different approaches to organisational structure. We will moreover consider how strategic choice influences structure before reflecting on different elements of organisational design and structure as well as strategic outcomes.

Organisational structure plays a critical role in the effective implementation of strategy, and accordingly in the achievement of the various strategic imperatives. The reason for this is self-evident in the following definitions of organisational structure.

Organisational structure is defined as the formal pattern of interactions and coordination designed by management to link the tasks and patterns of individuals and groups in achieving organisational goals.³⁰

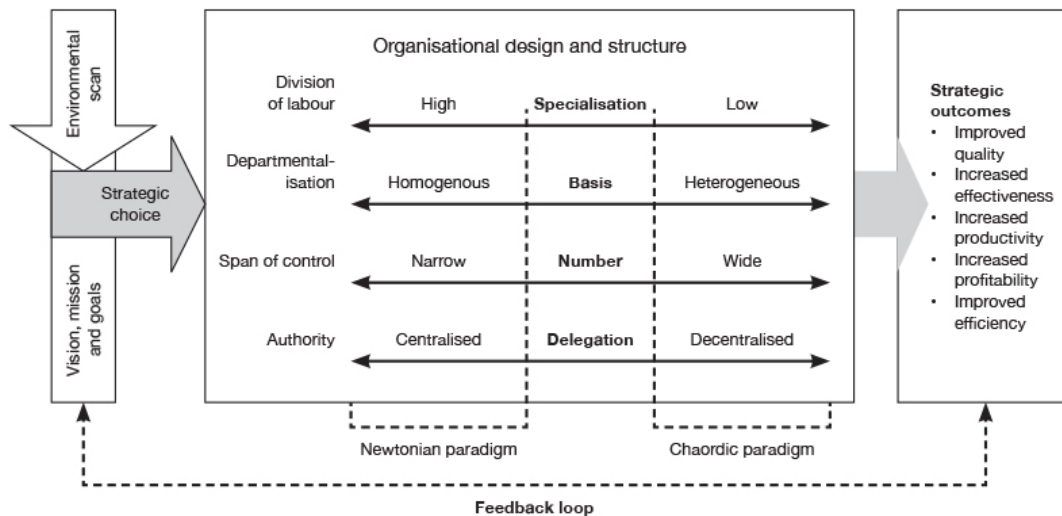
Structure is also the pattern of relationships among positions in the organisation and among members of the organisation. Structure makes possible the application of the process of management and creates a framework of order and command through which activities of the organisation can be planned, organised, directed and controlled.³¹

When designing an organisational structure and thus elaborating on Lee et al.'s model presented in Figure 13.1, the organisation needs to pay attention to a number of critical organisational areas. Figure 13.3 depicts the categorisation that helps inform organisational design. At the same time, Figure 13.3 also illustrates how organisational design and structure is not only informed by the strategic direction of the organisation, but also affects strategic implementation.

The approach to organisational structure is also determined by the relevant paradigm. Figure 13.3 illustrates this with reference to two particular paradigms, namely the Newtonian paradigm and the chaordic paradigm.

Paradigms are simply worldviews. Conventional wisdom leads us to believe that the world around us is ordered and predictable. The Newtonian paradigm is predicated on Newtonian science. This paradigm entrenches the belief that the world around us works much like a well-oiled machine, and that relationships between events are relatively linear, i.e. if X happens, then Y will be the outcome.³² This paradigm has flourished particularly under conditions where stability and a predictable future have been the status quo. Characteristics of this paradigm are centralised management, hierarchical organisational structures, and rule-bound bureaucratic environments in which individuals are seen as 'cogs in the machinery', and managers as 'conductors of orchestras'.

Figure 13.7 Integrated strategic framework of organisational design and structure



The chaordic paradigm, however, presumes less predictability and stability in an age of greater change and ambiguity mediated by global forces and competition. This paradigm is based on chaos theory, which in turn is born out of complexity theory, and is accordingly predicated on 'complex, unpredictable and orderly disorder'.³³ It was Dee Hock, the founder of Visa, who coined the term 'chaordic' – a combination of chaos and order. 'In chaordic systems,' as Hock suggested, 'order emerges. Structure evolves. Life is a recognisable pattern within infinite diversity.'³⁴ We find tangible evidence of these recognisable and identifiable patterns, which emerge from chaos, in nature and, more particularly, in fractals. Fractals are geometric, self-replicating shapes that can be divided into many parts, each of which is similar to the original object. Examples of fractals are snowflakes and the fronds of a fern. All snowflakes are hexagonal, yet each one is unique and self-replicates so that a part of a snowflake is a scaled-down version of the original one.

Understanding this chaordic paradigm in the context of business and organisations is important given the current state of the business environment. What creates order from chaos is ultimately commonality of purpose with all players following the same rules or principles. By adhering to such tenets, recognisable patterns of behaviour may emerge. This is particularly profound in virtual organisations where there is a complex pattern of interrelationships among partners, and the only commonality between the different players is the vision that bonds them.

In terms of organisational structure, chaordic organisations are more flexible, flatter entities that tend to devolve authority as much as possible, and allow a high degree of autonomy in decisionmaking and self-directed behaviour. Accordingly, there is a wide span of control so that managers are less involved in the daily coordination of employees' activity. Such a decentralised approach to authority is predicated on a strong value system to which all players adhere, and which ensures commonality of purpose in the absence of control. 3M is often quoted as an example of a chaordic organisation. This organisation has espoused innovation as its central tenet, and has accordingly allowed employees the latitude to be creative. The result is that it has reaped the benefits of new product development through self-directed behaviour.

13.3.4.1 The influence of strategic choice on organisational structure

As Figure 13.7 illustrates, the choice of strategy plays a critical role in informing the nature of the organisational structure. Current demands for efficiency, global effectiveness and flexibility, for instance, largely call for organisational structures that are appropriately responsive. This is relatively easy to determine in terms of division of labour, span of control and authority:

- A fairly low degree of labour specialisation is required with individuals having more autonomy over their jobs and more to do.
- Managers have a far wider span of control, with jobs being complex and individual employees having greater decision-making powers.
- There is a far greater devolution of authority throughout the organisation.

Approaches to departmentalisation, which correspond to these structural determinants, are arguably less prescriptive. Ideally, organisations should be flatter and less hierarchical to ensure maximal flexibility with less bureaucracy. As such they would be seen to be chaordic in nature from a paradigmatic perspective. However, organisations may choose structures to conform to overarching concerns of customer responsiveness (divisional approach), brand or project completion (matrix approach), or global penetration (divisional approach by region). Moreover, because of the cost-effectiveness offered by outsourcing, a virtual approach might be advantageous. (We discuss the virtual organisation in more detail below.) Each of these structural approaches to departmentalisation has its relative advantages and disadvantages. The organisation should therefore select the approach with the best fit in terms of strategic direction.

13.3.4.2 Elements of organisational design and structure

Thus far we have reflected on the relevance of strategic direction in informing the choice of organisational design and structure. As illustrated in Figure 13.7 above, a number of key components, namely the division of labour, departmentalisation, span of control and the delegation of authority, determine organisational structure and design. We will discuss each of these below. We will then reflect on the context in which they occur as governed by two different paradigms, namely the Newtonian paradigm and the chaordic paradigm.

Division of labour

Division of labour refers to the degree of specialisation of jobs in an organisation. We can divide jobs according to the following:

- *Skill or expertise:* Organisations, for instance, may comprise accountants, marketers, HR practitioners and various types of artisans.
- *Sequencing and task dependency:* The best example here is that of a production line in, for example, a vehicle-manufacturing plant. Before the vehicle can be painted, it must be assembled. Artisans might be assigned to either function.
- *Degree of authority:* This refers to the amount of decision-making power that an organisation devolves to the individual.

In highly specialised environments, jobs have a narrow focus, are highly repetitive and have limited scope. For instance, in garment factories, it is not uncommon to find one worker measuring material, another cutting, and another sewing, while a final worker finishes the outfit. Such specialisation is often seen as the backbone of mass production, and indeed is often proposed as the *raison d'être* of the post-industrialisation organisation.

Organisations with low specialisation usually delegate more authority to the individual through job enrichment, and increase the scope of the job to include more tasks through job enlargement. This situation is typical of service-based organisations seeking to globalise rapidly. In such organisations where efficiency of service delivery is key, streamlined processes, as well as a high degree of multitasking, are characteristic elements.

Departmentalisation

Departmentalisation refers to the process of grouping jobs together in an organisation. An organisation may group jobs according to type, product or even location. An organisation typically uses organograms (organisational charts) to depict departmentalisation. Organograms are line diagrams that indicate how jobs are grouped, as well as lines of authority. There are many ways to group jobs in an organisation. However, the most common forms of departmentalisation include:

- the functional approach
- the divisional approach
- the matrix approach; and
- the virtual approach.

In brief, the functional structure is perhaps the simplest one, as reflected through traditional organograms, with organisations being structured according to various common functions. Problematically, however, functions generally operate in silos under this structure without any real integration. The divisional structure tends to group jobs by area, product or customer rather than by function. There is a strong customer orientation, and functional strategies are better aligned. However, resourcing becomes problematic through duplication as well as competition. The matrix structure is a hybrid structure in essence. Here, divisional or project structures are combined with functional structures, with individuals drawn from different functions in the organisation to work on a different projects in the form of new product development, for instance. Here, there is stronger work on, for instance, project completion and/or new product development but the structure lends itself to role ambiguity, conflict and turnover among employees. Finally, virtual structures involve the outsourcing of work to a greater or lesser extent to external service providers who are, by all accounts, cheaper and more efficient than doing the work internally. However, coordination costs associated with having external services providers are high. Each of these different structures is explored in more detail in [Table 13.5](#). Each structure is described before various advantages and disadvantages are discussed.

Figure 13.8 The matrix approach

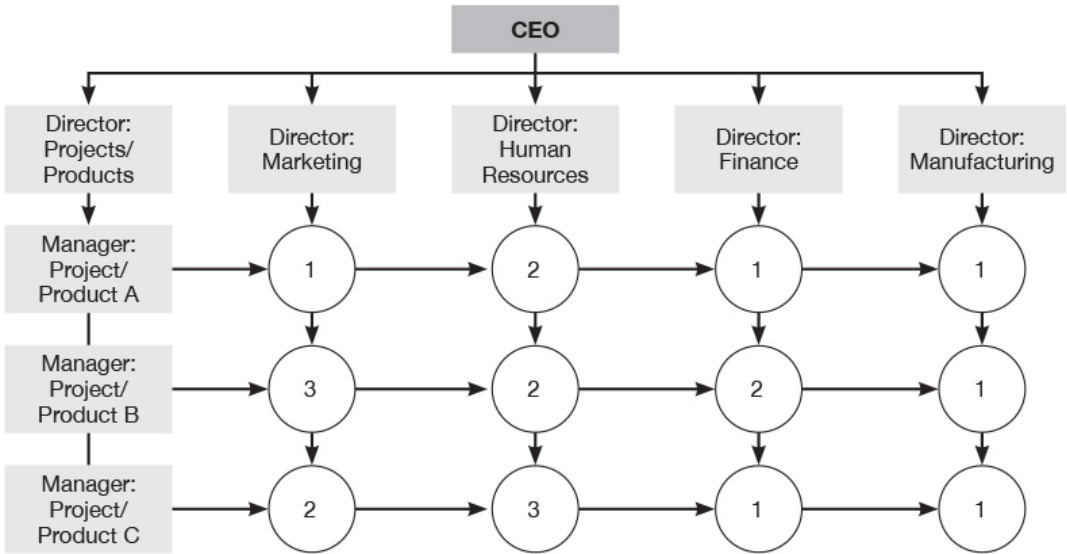


Table 13.5 Different approaches to departmentalisation

Type of structure	Description	Advantages	Disadvantages
Functional	• Involves the grouping of jobs in the organisation according to a particular function such as marketing, human resources, finance, information systems, operations (including production or manufacturing), and research and development • Importantly, each function has its own functional strategy to help it realise the overall vision of the organisation. While these strategies are often unique and idiosyncratic to an organisation, Table 13.6 outlines typical strategic directions a function might follow	• Relative simplicity: Functional structures are the most basic and easy to understand of structures • Specialised expertise in different areas: Clustering jobs according to functions allows for specialised expertise (for instance, the HR function might have specialised recruiters, training and development specialists, etc.)	• Lack of integration: Different functions are often not well integrated, resulting in employees operating in relative silos without any real sense of how their job relates to the organisation as a whole

Type of structure	Description	Advantages	Disadvantages
Divisional	- Divisional structures reflect jobs grouped according to product type, region or customer.³⁵ - Product type: Reflects all activities related to the production, marketing, research and development, and selling of a specific product, particularly when there are relatively large differences between product type, thus requiring fairly specialised knowledge and focus - Region: Reflects a focus on providing specialised services and products for specific geographic areas, particularly where operations are geographically dispersed and where there is a need to respond to differing cultural, ethnic, socioeconomic and political conditions - Customer: reflects a focus on servicing the needs of various customers, particularly when there are significant differences between customer groupings in an organisation	- Strong customer orientation: Regardless of divisional approach, organisations are more strongly customer oriented since they can focus on specific needs according to product or region - Stronger alignment between unit and functional strategy: By incorporating functions, divisional managers are better able to develop a generalist approach to the development of integrated and interrelated responses. By implication, functional managers at the divisional level are generalists (for instance, the HR manager would be responsible for recruitment, and training and development, rather than only one of these focal areas)	- Duplication in resources: Each division has its own functions, resulting in a replication of activities - Competition for resources: Unhealthy levels of competition may result in divisions focusing only on their own goals and objectives rather than those of the organisation as a whole³⁶
Matrix	- This approach involves an overlay of a divisional or project-driven structures on a functional structure (see Figure 13.4). Typically, this sort of approach is used in project and brand-dominated organisations. It serves as an alternative to the divisional approach by product and is also commonplace in project-based organisations - Each of the nodal points where the functional and divisional structures intersect in Figure 13.4 represents one or more employees drawn from the relevant function to work on the project/product development. Authority over the employees may vest with the functional manager or the project manager, or both in a joint capacity. Determining where authority lies is dependent on the form of matrix adopted.³⁷ In a weak matrix, the functional manager has more authority over the project, while the project manager acts as an administrator. With a strong matrix, however, the project manager has authority over the project, even though the functional manager retains title of his or her employees. In a balanced matrix, authority vests in both project and functional managers equally, and different roles are shared.	Stronger focus on the project/product completion: Project/product developmental work becomes the focal point for staff who are seconded to projects. As such, staff can bring their knowledge and skills to bear when and as needed.	- Ambiguity in reporting relationships: Staff are now beholden to two managers, which leads to stress - Dysfunctional conflict: There is a heightened propensity for conflict between the different managers, who may have conflicting agendas and who vie for status, legitimacy and power - Competition for scarce resources: Unhealthy levels might arise as research is now shared across multiple functions and projects - Further complications are drawn out in the Case example The matrix organisation in the telecommunication's industry below
Virtual	- Typically, the virtual approach entails the outsourcing of non-core functions that do not provide a competitive edge, which in turn allows them to focus on their core competencies (see Figure 13.5) - Outsourcing refers to the use of external agents to perform one or more organisational activities.³⁸ In so doing, organisations effectively opt to return to the market for the provision of services from external vendors as they believe this to be more cost effective and efficient than retaining these functions in the traditional organisational structure. At the same time, they are now able to focus on their core business. Potentially, since practically all organisations outsource to some extent, there is a tendency towards becoming virtual over time.	Reduction in transaction and production costs through the reduction in information costs: Historically, organisations existed because they reduce information costs related to establishing the prices of various service providers.³⁹ Through the internet it is now possible to source dedicated alternatives in the market to produce goods and services (as opposed to centralising functions). All things being equal, costs associated with these means of production should be cheaper due to economies of scale.⁴⁰ Here, the sharing of costs among multiple clients in an outsourcing environment leads to a cost reduction.	Higher coordination costs: Markets tend to incur higher coordination costs through the setting up and administration of contracts, and the monitoring of behaviour.⁴¹

Table 13.6 Broad strategic thrusts of major functional areas⁴²

Function	Strategic thrust
Human resource management	- Staffing the organisation with the right calibre of people who have the requisite skills and knowledge at the right time - Instituting appropriate performance management systems to monitor, reward and remedy performance when necessary - Providing appropriate compensation that is performance-linked to increase productivity and output - Providing training and development that is linked to the strategic imperatives of the organisation - Compliance and full engagement with the labour legislative framework - Cooperative and equitable labour relationships that underscore workplace democracy and worker participation - Implementing appropriate measures to respond fully to the needs of and accommodate an increasingly diverse workforce
Marketing	- Identification of target market through market aggregation and/or market segmentation - Satisfying the needs of the target market through focusing on the traditional 4 Ps (product, place, price, and promotion)
Finance	- Analysing and assessing financial performance through the application of ratio analysis to financial data - Use of financial planning to ascertain whether future cash flows are sufficient to cover capital investments and dividend payouts - Ascertaining the best mix of debt and equity financing to make up shortfalls from internal financing generated from income

Function	Strategic thrust
Information systems	- Implementing cross-cutting, functional-specific information systems to support HR, marketing, finance, and operations - Adopting decision-support systems, executive and management information systems, and knowledge work systems to assist in the development and implementation of organisational strategy
Operations strategies	- Designing process strategies, including process, product and repetitive-focused strategies, that underscore the production of goods and services - Implementing capacity strategies that focus on the optimisation of facility usage to account for future demand for goods and services - Adopting layout strategies that improve usage of space, equipment and staff, as well as information flow and customer interactions - Strategically locating the operation with consideration given to proximity of suppliers, access to transport, proximity to markets, availability of suitable labour, as well as government policy and regulation - Ensuring appropriate job design through job enlargement and enrichment interventions, as well as through teamwork, ergonomics, and work scheduling - Adopting suitable global management strategies such as just-in-time management, quality management, supply-chain management, and inventory management
Research and development strategies	- Carrying out basic and industrial research to advance new knowledge and test the profitability of new ideas - Undertaking new product (and process) design and development (with specific attention being paid to the infusion of unique and distinguishing features and characteristics) - Creating an environment conducive to innovation and R&D activity, with an emphasis on a culture of risk taking and reward, as well as the creation of and allocation of resources to dedicated research teams

STRATEGY IN ACTION: The matrix organisation in the telecommunication's industry⁴³



In their case study of an organisation in South Africa's telecommunications industry, Tobin and Franze found that the matrix organisational structure adopted by the organisation tended to dilute its ability to integrate and share knowledge. The reasons posited for this included:

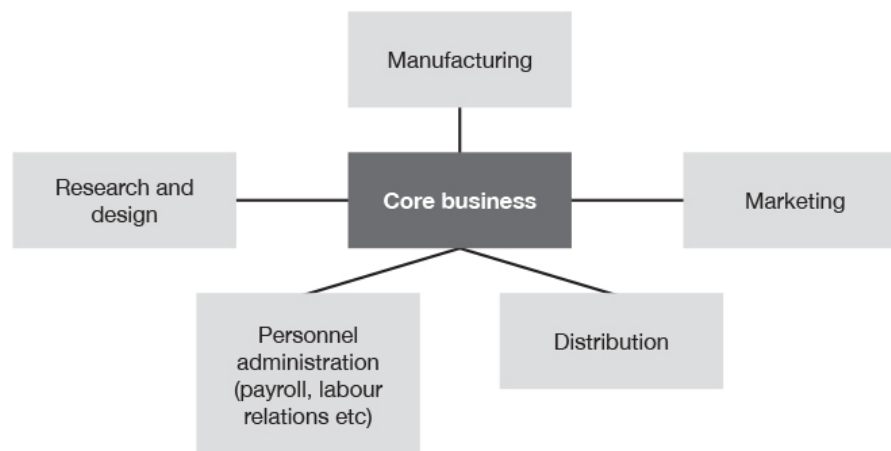
- an excess of departments that were too specialised, and that resulted in a dispersion of knowledge, with personal contact also being limited accordingly
- the separation of performance from reward, which tended to disincentivise the sharing and integration of knowledge
- a lack of any clear mechanism for employees to share and integrate tacit knowledge
- ambiguity in the reporting relationship with a disconnection in terms of flow of performance-related information pertaining to employees between the project and functional managers.

Implications of this research suggested that the structure of the matrix organisation is vitally important. The organisation should keep departments to a minimum, thus allowing for more sharing of knowledge. At the same time, it should incentivise employees to share knowledge in the organisation, and avoid a culture that engenders knowledge as a form of competitive advantage among them. Finally, the organisation should establish clear reporting relationships, with functions and roles of project and functional managers clearly demarcated. In particular, it should establish strong lines of communication between the two levels of management.

Questions

1. Matrix organisations, despite their relative complexities, are often favoured over functional and divisional structures. Would you recommend this structure based on what you have learned about it? Substantiate your answer.
2. How might the matrix structure lead to better integration in terms of Lee et al.'s architecture?

Figure 13.9 The virtual approach



Span of control

The third component of organisational design and structure in terms of Figure 13.7 is the span of control. Span of control refers to the number of employees reporting either directly or via working groups or committees to a manager. The span of control is affected by a number of issues:⁴⁴

- *The amount of contact required between the employee and the manager:* Where jobs are subject to time constraints or have a high degree of uncertainty, a greater degree of coordination is required to ensure efficient and effective delivery. There is thus a lower ratio of staff to managers (i.e. fewer employees per manager or a smaller span of control is preferable).
- *The extent to which work is specialised:* Lower-order jobs that are highly specialised and less complicated require less supervision because of their highly repetitive nature. At the same time, employees working in more complicated higher-order jobs in flatter organisations are allowed greater autonomy because their work is more specialised and potentially beyond the technical expertise of managers. In both instances, there is a large span of control.

- *Nature of the organisation:* Flattening or downsizing organisations by reducing the number of employees as well as the tiers of management is commonplace given the increasing trend towards globalisation. There is a natural tendency to have wider spans of control when organisations become flatter.

Delegation of authority

The fourth and final component of organisational design and structure in terms of [Figure 13.3](#) is the delegation of authority. This essentially refers to the dissemination of decision-making powers throughout the organisation. In particular, the organisation will endow non-managerial employees with such powers. The arguments for delegation are the following:

- Employees are better motivated by being given greater responsibility, control over their work and decision-making powers (in essence, job enrichment).
- Managers, particularly in flatter organisations, are freed to focus on strategic decision-making as they do not have to micromanage the activities of their employees.
- A democratic work environment is created through the involvement of employees in decision-making structures in the organisation (see the Case example *Disclosure of information* below).
- The delegation of authority enhances the careers of lower- and middle-order managers who are involved in more complex, higher-order decisions.
- More autonomy results in more innovative and effective solutions as well as better decisions, leading to a more efficient allocation of resources. Here, decision-making must be linked to performance management while also contributing to a healthy level of internal competition between individuals and departments.

However, delegation of authority can lead to:

- Undue stress, particularly when employees are not equipped with the knowledge and skills to follow through with decisions, or quite simply do not want the added responsibility
- A perception that the managerial prerogative is being eroded since managers are no longer the sole decision-makers in the organisation
- Ineffective and inefficient decision-making since lower-level employees do not have the expertise and knowhow of management.

CASE EXAMPLE: Disclosure of information⁴⁵

Disclosure of business and financial information by the employer is a critical part of effective worker participation and a true test of management's commitment to the process. Employees are better able to make more informed decisions and have a greater impact on the decision-making process if they have the right information at their disposal. Moreover, a greater degree of transparency on the part of the employer will ensure that employees have a greater understanding of the workings of the organisation, and they will thus identify more closely with the organisation's aims and objectives.

Under the 1956 Labour Relations Act, disclosure of information was enforced through the doctrine of good faith bargaining, as well as industrial and labour appeal court decisions pertaining to retrenchments.⁴⁶ Since 1994, the South African government has made great strides in rectifying this rather nebulous position by creating an environment that is more conducive to information sharing. Section 32(a) of the Constitution of South Africa Act 108 of 1996 grants everyone the right of access to information held by the state, while Section 32(b) grants everyone the right of access to any information held by another person if this information is required to exercise or protect any other right. The Promotion of Access to Information Act 2 of 2000 gives effect to this constitutional right.

The Labour Relations Act 66 of 1995 also enforces the disclosure of information conducive to harmonious labour relations. In terms of Section 16, employers are required to disclose all relevant information to majority unions (or minority unions acting in consort to form a majority) to ensure effective consultation and collective bargaining. Section 89 provides for the disclosure of information relevant to effecting consultation and joint decision-making within the context of a workplace forum. The relevance of information is determined by those matters listed in Sections 84 and 86 in the Labour Relations Act 66 of 1995 for consultation and joint decision-making respectively.⁴⁷ Typically, however, the types of information likely to be disclosed will include productivity information, information on the morale of workers, information pertaining to wages and benefits, safety information, information on company performance, information on wealth sharing, and information on the organisation's future.⁴⁸

In a 1997 study that sought to gauge the perceptions of South African management to information disclosure, Grossett⁴⁹ found that while levels of disclosure of information were quite low, several perceived benefits emerged. These included:

- improved employee commitment
- increased employee satisfaction and cooperation
- improved engagement of employees in decision-making
- increased understanding on the part of employees of decisions taken by management
- improved public perceptions of the company.

Management perceived, however, that the disclosure of certain classes of information, such as those deemed sensitive and commercially confidential such as information pertaining to directors' remuneration, would have a negative impact on employees' commitment, cooperation and levels of trust.⁵⁰

In a later in-depth study of seven organisations with workplace forums, Van der Walt⁵¹ sought to elicit the views of both management and employees. He also found that while there was support for information disclosure, management was loath to disclose information that they felt would threaten their prerogative, or that was sensitive and confidential.⁵² Employees, however, felt that information disclosure was insufficient.

Evidence therefore shows that South African organisations still succumb to issues of mistrust and suspicion when it comes to the disclosure of relevant and necessary information. However, information sharing is a vital and dynamic component of effective participation. It is thus incumbent on management to foster the necessary environment for the exchange of information, and to realise the benefits of information disclosure by engaging more fully with the process.

13.3.4.3 Strategic outcomes

The final component of the integrated framework reflected in [Figure 13.3](#) is that of strategic outcomes. As illustrated, a sound organisational structure and design will result in key strategic benefits for any organisation. Some of these generic outcomes include:

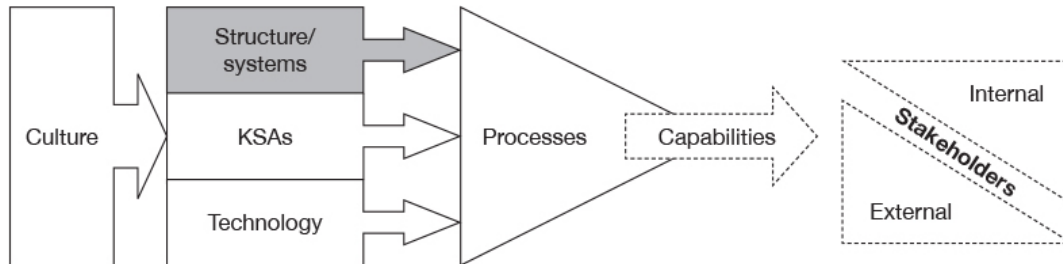
- *Improved effectiveness and efficiency* as a result of better, more streamlined organisational design
- *Better quality of goods and services* resulting from, for instance, the organisation giving more discretion to employees with regard to the production process
- *Increased productivity* as a result of the organisation giving more autonomy to employees, as well as through a better structured organisation that facilitates a greater exchange between functions and departments.

The particular paradigm that governs the organisational structure also determines the outcomes. It may be argued that a chaordic paradigm that vests more autonomy in the employee and calls for a flatter organisational structure will most likely result in the strategic outcomes listed in Figure 13.3.

Finally, Figure 13.3 includes a feedback loop, the purpose of which is to highlight the dynamic nature of organisational design and structure. The loop, which links strategic outcomes to strategic choice, emphasises the fact that outcomes ultimately moderate not only the formulation of strategy, but also the design of organisations to achieve the desired outcome.

13.3.5 Systems, policies, and procedures

Figure 13.10 Lee et al.'s organisational architecture



A well-established framework of systems, policies and procedures that are strategically supportive is key to driving the core processes of the organisation, and therefore in achieving strategic alignment and implementation.

13.3.5.1 Reward systems

How organisations reward employees is singularly important in the implementation of processes and, ultimately, the achievement of strategic outcomes. It is common practice for managers to provide financial and non-financial incentives to retain the commitment and loyalty of employees, and to direct their behaviour towards the achievement of the organisation's goals.

Financial or tangible rewards include combinations of bonuses, performance-related pay, shares and share options, as well as benefits. Non-financial or intangible rewards are directly related to the job itself. They include ways to improve overall job satisfaction by making work more challenging through the techniques of job enrichment and enlargement, as well as making the work environment more stimulating, friendly, pleasant and accommodating. While organisations tend to focus on financial rewards, they should not discount the power of non-financial incentives.

Ideally, a strategically aligned reward system should incorporate the following principles:

- Financial reward and pay should be internally equitable and acceptable to employees with the principle of 'equal work for equal pay' applying at all times. Moreover, the gap between the highest- and lowest-paid workers should be closely monitored and legitimised, such that all workers understand its rationale (see the Strategy in action *Accountability, ethical remuneration needed to boost corporate governance* – PwC below).
- Reward should be market related in order to ensure that employees are retained. Where an organisation cannot match the levels of pay of competitors, then non-financial rewards should be considered.
- Reward should comprise a healthy mix of financial rewards (bonuses, shares, benefits and performance incentives over and above a competitive basic salary) as well as non-financial rewards (flexitime arrangements, job enrichment as well as job enlargement).
- The organisation should always link financial incentives to output and performance, and not merely attendance behaviour or even just doing the job.
- The organisation should link performance-related rewards directly to the attainment of goals and objectives that are strategically aligned. At the same time, these goals and objectives must be attainable but challenging. Such a system should apply to and be fully understood by all employees.
- The organisation should ideally link executive-level reward to overall organisational performance in the form of share options and share ownership schemes. Similarly, reward for other levels of employees should be linked to areas of responsibility. For instance, the head of marketing would have reward linked to customer satisfaction, sales volume and market share.
- The organisation must keep the time gap between performance and reward to an absolute minimum.
- The organisation should ensure that reward practices are appropriate when managing a diverse and/or global workforce such that cultural sensitivities to different reward practices are taken into account.
- Finally, an organisation should never reward mediocrity, only good performance.

STRATEGY IN ACTION: Accountability, ethical remuneration needed to boost corporate governance – PwC⁵³

Rules on executive bonuses and incentives need to be tightened to boost corporate governance, professional services firm PricewaterhouseCoopers' (PwC's) 'Executive Directors: Practices and Remuneration Trends' report has found.

PwC Africa people head Gerald Seegers on Thursday stated during a briefing that remuneration reporting trends and the dynamics around 'say on pay' have changed since the introduction of the amended JSE listing requirements in May last year, which calls for fair and responsible remuneration reporting that must be implemented across an organisation – with a special focus on junior employees.

The PwC report looked at the impact of corporate failures on executive remuneration and considered whether the time has come for companies to put risk-adjustment mechanisms such as malus and clawback to the test. This is against the macroeconomic backdrop of increasing corporate failures in South Africa and persistent inequality.

Malus provisions are used as an ex-ante risk adjustment over executive pay. These provisions are usually imposed over executives' short-term and long-term incentives. The trigger events for malus are often the same as or very similar to those prescribed for clawback. Clawback creates the obligation for executives to repay amounts to the company that should rightfully not have been paid to them.

The question PwC raised was what effect a breach of fiduciary duties or misconduct will have on the remuneration of executives and whether companies should claw back incentives paid to or vested in culpable executives in the event of a corporate failure. 'In light of the current climate and recent corporate failures, companies need to look at whether they have the appropriate measures in place to hold executives to account if the need arises and, if necessary, recover their variable pay,' said Seegers.

Moreover, the report considers the future of executive benchmarking, which has been a traditional tool used to attract and retain employees who are critical to the performance of the organisation. PwC stated that a new approach to benchmarking is suggested that first involves the determination of a pay range for executives, followed by determining a particular executive's movement through the range, which would be linked to performance through the executive's tenure.

Ethics of pay

Fair and ethical remuneration, and the most appropriate measures government, business and labour and other stakeholders must take in order to better the lives of more junior workers to establish a 'living wage' remains under debate.

The Gini coefficient of the employed has declined slightly to 0.429 in 2018 from 0.431 in 2017 and decreased significantly from 0.44 in 2014 when PwC first measured this indicator.

The pay ratio for a company, which is the ratio between the total remuneration of the CEO of a company and the average of the total remuneration of all other employees of the company has increased from 61.8 in 2017 to 64.7 in 2018.

On May 1, the first national minimum wage was introduced in South Africa at R3 500 a month. The conflation of the concepts of a 'minimum wage' and a 'living wage' has led to disputes over the course of this year with organised labour.

There is no definitive study available to establish a South African living wage level, but the general view among reward professionals and large corporates is that a living wage is around R10 000 to R12 000 a month.

The PwC report also discussed the progress made nationally and internationally regarding the gender gap in remuneration. The World Economic Forum's 2017 'Global Gender Gap' report indicates that 68% of the global gender gap has been closed, a decrease from the 2015 and 2016 results. However, it also estimates that the global workplace gender gap will not be closed for the next 217 years.

In South Africa, the proportion of women to men in executive roles is still low. 'We examined the gender total guaranteed packages (TGP) median pay gap in 2017 among JSE-listed companies. We also explore how local and global institutional investors have taken steps to hold companies to account on whether they have promoted gender diversity and representation on their boards,' said Seegers.

Remuneration trends

The report reviewed the TGP for all executives paid; the median for CEO remuneration went up by 7.6% to R5.2 million in 2017, and the report also included an overview of short-term incentives paid to executives.

Further, the average pay for the CEOs of the ten largest JSE-listed companies was R24.9 million in 2017. For CFOs the average is R15.1 million and for executive directors R8.7 million.

The executive pay for each sector was also analysed. There are 46 companies included in the JSE's basic resources sector, with only seven listed among the large-cap companies on the JSE. Oil & gas producers have now been included in this sector.

The median TGP for CEOs of large-cap basic resource companies is R24 million and the median TGP for executive directors is R18.7 million.

The financial services sector is under sharper scrutiny than ever and the responsibility on directors' shoulders have increased. The median TGP for the CEOs of large-cap companies in the financial services sector showed an above-inflationary increase of 14.9% (to R8.6 million). The median TGP for the executive directors showed an increase of 15.5% (to R5 million).

Many companies in the industrial sector are showing little growth because of slow economic growth. The median TGP for large-cap CEOs at industrial organisations showed a moderate increase of 5.8% (R16.1 million). The median TGP for executive directors showed an increase of 2.8% (R5.8 million).

The median TGP for the CEOs of large-cap service companies showed a significant increase of 15.6% (R9.3 million). Similarly, the median TGP for executive directors increased by 12.5% (R4 million).

'In conclusion, benchmarking methodologies on executive remuneration need to be developed further. The challenges that remuneration specialists and remuneration committee members face is the design of strategies and policies that are aligned with sound corporate governance principles, while motivating executives and safeguarding shareholder interests.

'Only by challenging the status quo regarding how remuneration policies have historically been approached will we be able to do our part to guard against corporate failures and play our role in creating future-proof organisations that are focused on sustainable value creation,' Seegers said.

Questions

1. Why should businesses be concerned about the pay levels of executives? When answering this question, reflect on issues relating to both the pay gap and the performance of businesses.
2. Do you think that malus and clawback provisions are beneficial? Why or why not? Explain the strategic rationale underlying your answer.

13.3.5.2 Performance management systems

Performance management systems help align individual performance with the organisation's strategy. The organisation needs to appraise, assess and remedy performance regularly to ensure that employees are meeting performance objectives. To be effective in aligning performance with strategy, a performance management system should incorporate the following:

- Performance management systems should play three major strategic roles. They are first and foremost developmental in nature – they allow organisations to identify deficiencies in employee performance, and to rectify them through training. At the same time, performance appraisals also play an evaluative function by allowing organisations to reward good performance and 'punish' poor performance when necessary. Finally, performance management systems allow organisations to validate the efficacy of other practices in the organisation such as selection.⁵⁴
- Organisations need to pay attention to the type of appraisal tool they adopt as part of the performance management system. Such tools can either be outcomes or process based. An outcomes-based appraisal focuses specifically on the deliverables, and is based on objective, verifiable results. It uses measures such as management by objectives. A process-based appraisal relies on assessing how the employee performs the work, and is based on judgements about an individual's performance. This type of appraisal uses rating scales and the like. Generally, a combination of both approaches produces the desired outcome.
- Organisations must ensure that they assess performance accurately and fairly. Raters should be careful not to succumb to various judgement-based errors such as the halo effect, strictness, leniency, central tendency, bias and recency.
- Understanding who carries out the appraisal is also of strategic significance. Multirater or 360-degree feedback has grown in popularity of late. This system incorporates input from various sources such as supervisors, colleagues, self-evaluations and, importantly, customers. The advantage of this system is that it addresses the various rater errors mentioned above.
- Feedback from any form of appraisal should be timely and instructive. It should include those areas where improvement is deemed necessary, as well as the strengths in the individual's performance.
- Organisations should train managers to rate and provide feedback effectively.

- Organisations should pay attention to appraisal and feedback in multicultural environments where different emphasis may be placed on different aspects of performance.

13.3.5.3 Policies and procedures

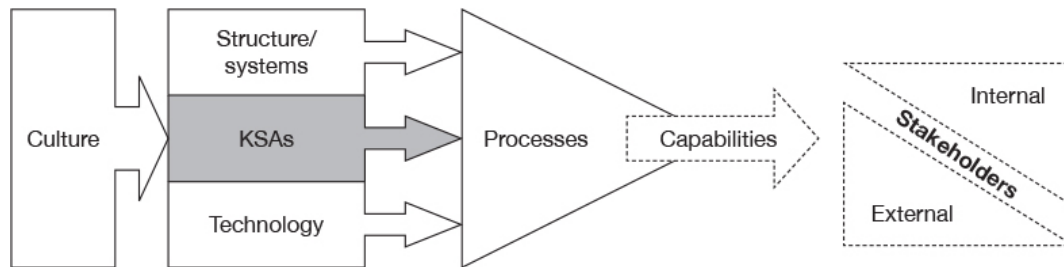
An organisation designs policies and procedures to guide and align its members in their activities and behaviours. As such, policies and procedures facilitate strategic alignment and implementation in three ways:⁵⁵

- Policies and procedures are prescriptive in nature, and are intended to guide and create uniformity in behaviour.
- Policies and procedures create consistency in operations across geographically dispersed subsidiaries, plants and outlets.
- Policies and procedures facilitate the formation of an organisational culture conducive to strategic implementation.

Note, however, that too many policies and procedures are likely to create a bureaucratic quagmire simply because they are likely to block activity and stifle ingenuity. While policies and procedures should create a sense of boundaries, they should primarily guide and facilitate effective and efficient behaviour, decision-making and practices.

13.3.6 Knowledge, skills and abilities (KSAs)

Figure 13.11 Lee et al.'s organisational architecture

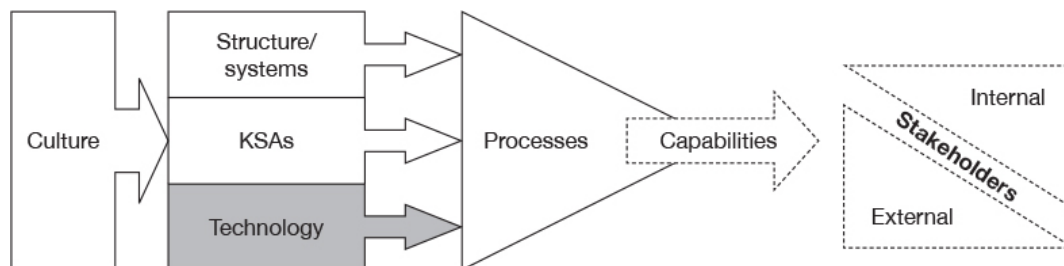


KSAs are fundamental drivers of strategic process. Also often called competencies, KSAs include the requisite expertise and knowhow necessary to run the organisation efficiently and effectively to retain a competitive edge. There are three types of KSAs:

- Basic KSAs:** These include the various knowledge, skills and abilities required by all members of the organisation. These building blocks are considered necessary to maintain the organisation's functionality on a day-to-day basis.
- Specific KSAs:** These relate to performing **core competencies** and key operations in the organisation. These KSAs are crucial elements of strategy, and relate, for instance, to knowhow pertaining to more efficient operating systems, and expertise in innovation and new product development.
- Distinctive KSAs:** These are specific in that they provide competitive advantage because they are unique and superior to what competitors have. In other words, a specific KSA relating to a core competency does not automatically translate into a competitive advantage unless it provides the basis for competitive superiority.⁵⁶ Market leaders in particular industries, therefore, usually enjoy the strategic advantage of distinctive KSAs. While their rivals might have specific KSAs that are quite similar, market leaders possess something unique that provides them with the competitive edge. The distinctive and unique KSAs provided by Mark Shuttleworth and his team turned his IT company, Thawte Consulting, into a billion rand undertaking. KFC's 'secret blend of herbs and spices' undoubtedly contributes to making it a global leader in the fast-food industry.

13.3.7 Technology

Figure 13.12 Lee et al.'s organisational architecture



Technology is core to the effective implementation of processes in almost all organisations. Technology is quite simply defined as 'the application of scientific knowledge for practical purposes, especially in industry'.⁵⁷ This is seen to include the knowledge required to transform inputs into outputs through the production process.⁵⁸ Technology is thus also taken to mean the actual tools, machines and the like developed from this knowhow, which make the transformation of inputs to outputs possible. Finally, technology is often specific to a particular industry. Here we refer to 'a technology' that has particular application (for instance manufacturing technologies, medical technologies, mining technologies, and the like).

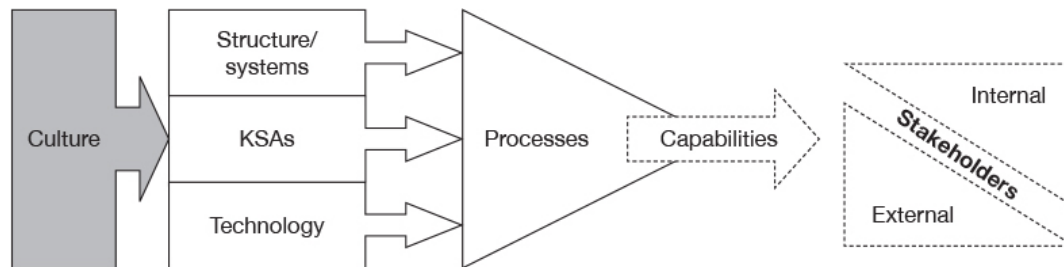
Technologies are generally short-lived, given the rapid pace of technological advancement that has characterised the last two decades. However, they are still capable of offering significant strategic advantage. This is ultimately derived from technological leadership. Being an innovator or pioneer of a new technology does not necessarily translate into competitive gain because of the costs involved in development and the likelihood of rapid uptake (and improvement) by followers. Rather, for many organisations being an early adopter means that technological innovations can be adopted with fewer problems and without the initial development costs. Advantages of being a technological leader through early adoption include:⁵⁹

- increased market share and higher profits by adopting new technologies ahead of competitors
- acquisition and adoption of tested and more reliable technologies, and greater choice as suppliers increase
- attraction of customers who gravitate towards organisations who adopt state-of-the-art products and services with cutting-edge technology
- opportunities to modify and improve technologies before late adopters catch up. This also means that early adopters can create barriers to entry, precluding late adopters from entering the market.

Adopting new technologies has additional implications for the organisation. The nature of the technology is of particular importance and is determined by the specific organisational needs. Ideally, all organisations require a base level of technology, common to all players in the industry. Key and pace technologies provide the necessary competitive advantage and are generally unique to only a few players.⁶⁰ However, regardless of the level adopted, training staff to develop and use technology proficiently is an absolute requirement, as are interventions to overcome any resistance to the introduction of new technology.

13.3.8 Organisational culture

Figure 13.13 Lee et al.'s organisational architecture



The final component of Lee et al.'s organisational architecture is culture. Culture is seen as a system of norms, values, and beliefs that bind the organisation's members together, unifying them in purpose. An organisation's culture therefore serves to underscore the drivers of process, laying the foundation for the type of structure and system adopted, as well as the nature of KSAs and the absorption of technology.

Cultures are unique to organisations. Schein defines organisational culture as 'a) a pattern of basic assumptions, b) invented, discovered or developed by a given group, c) as it learns to cope with its problems of external adaption and internal integration, d) that has worked well enough to be considered valid and, therefore e) is to be taught to new members as f) the correct way to perceive, think and feel in relation to those problems.'⁶¹ Colloquially this is simply seen to be the 'way things are done around here'.⁶² When a culture unites members effectively and is sufficiently widespread, accepted and entrenched, it then becomes a key influencer in both strategic alignment and strategic implementation.

An organisation's culture finds expression through a variety of manifestations. These include the following:

- *Language*: Many organisations use their own idiosyncratic lexicons to describe their processes, operations and general environment.
- *Folklore*: Organisations often use stories of spectacular successes (or failures) based on actual events to influence desired courses of action and outcomes.
- *Heroes*: Organisations draw on individuals who epitomise everything the organisation stands for and who are exemplary performers to induct and mentor newcomers to the organisation.
- *Symbols and rituals*: Logos, signs, badges and icons as well as customs and ceremonies such as team-building events, workshops and awards events are important and powerful indicators and disseminators of culture.
- *Dress code*: How organisations allow employees to dress also provides a sense of the nature of the culture. Jeans, T-shirts and trainers are typical forms of apparel of software development houses, indicating a more relaxed and laid-back atmosphere, while bankers and accountants stereotypically wear suits and ties that are more common in a formal, corporate environment.
- *Office layout*: The way in which the office environment is designed will give a further indication of an organisation's culture. An open-plan environment, for instance, allows for more open interaction among employees while segregated individual offices establish a sense of privacy, individualism as well as authority.

13.3.8.1 Dimensions of organisational cultures and alignment with strategy

While all organisations have unique cultures, management might use the following guidelines to provide an indication of how the organisation might position itself for effective strategic alignment and implementation.⁶³

- Individuals should identify and align with the goals and aspirations of the organisation they work for. This helps to regulate behaviour through a sharing of common belief and values.
- Emphasis should be on cross-cutting, process-driven, multidisciplinary teams that focus on strategic outcomes by drawing on the collective expertise of the organisation.
- The leadership style should favour transformational leadership such that more focus is placed on people in the organisation. (Chapter 12 discussed leadership in more detail.) Moreover, the culture should further serve to legitimise management.
- Different departments in the organisation should act interdependently rather than independently to achieve desired results.
- A fair degree of self-directed and autonomous work should be allowed.
- Risk tolerance should be quite high to facilitate innovation, an important driver of competitive advantage.
- Reward criteria should be aligned with performance and strategic outcomes.
- Constructive conflict, as a function of bottom-up communication, should be tolerated such that employees feel free to challenge and criticise openly in a bid to improve existing practices and processes.
- A strategic culture should not only emphasise the outcomes and outputs, but also 'how things are done' by shaping work processes, working environments, employee behaviour and customer orientation.
- Strategically positioned organisations are responsive to the opportunities and threats in the external environment.

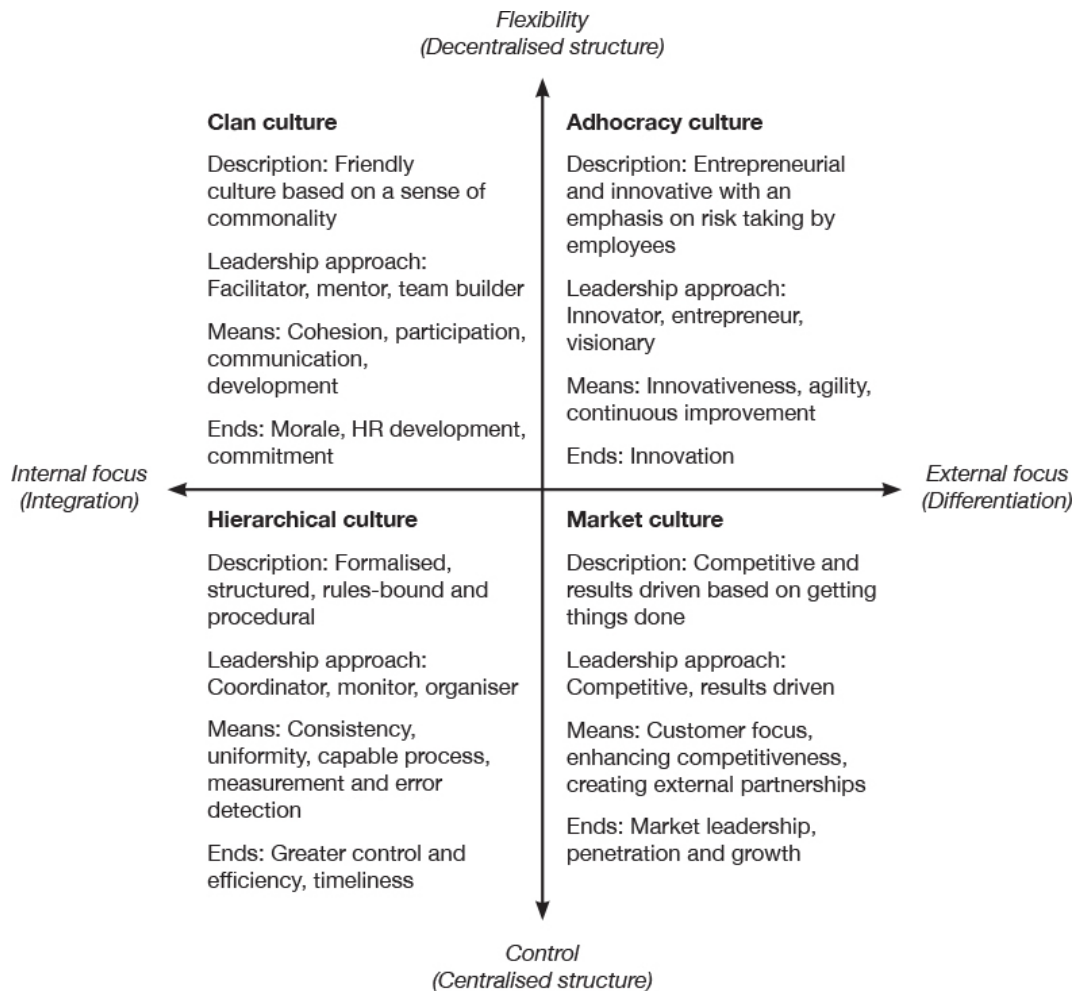
Ethical business practices and strong values should infuse the organisation's culture. 'Doing the right thing' should be an important part of the way an organisation does business. However, an organisation must take care not to pay lip service to values and ethics. These should be incorporated in policies, procedures, systems and processes, and be reflected in employee and managerial behaviour.

13.3.8.2 Types of organisational culture, leadership and culture and cultural change

Arguably the most important typology to have been developed in relation to types of organisational cultures is the 'Competing Values Framework' (CVF).⁶⁴ Based on Quinn and Rohrbaugh's⁶⁵ seminal work, the CVF seeks to describe the criteria underscoring organisational effectiveness. They identified three different value dimensions, which are plotted in Figure 13.6. Focus, on the horizontal axis, reflects internal harmony and integration on the one end, and external competitiveness and differentiation on the other. Structure of the organisation reflected on the vertical axis ranges from flexibility on the top to control on the bottom. Finally, means-end, which is reflected distally, suggests 'the behaviours that emanate from values and beliefs. These behaviours are the mechanisms (means) through which culture types are related with desired effectiveness criteria (ends)'.⁶⁶ Each quadrant in the model below depicts different culture orientations as well as associated means and ends, together with corresponding leadership styles. Here, clan cultures and adhocracy cultures both favour decentralised structures with an emphasis on flexibility. Clan cultures, which are internally focused, are premised on cohesion and participation as well as flexibility, are useful in building morale and commitment among employees. Adhocracy cultures are externally focused, and promote entrepreneurial and innovative behaviours in organisations. Hierarchical and market cultures, however, favour centralised structures with an emphasis on control. Hierarchical cultures are internally focused and tend towards creating more structure, consistency and efficiency. Market cultures are externally focused and are thus predominantly driven by competition, market share and growth. Each of these different cultural orientations is described in more detail in Figure 13.6.

Importantly, two observations might be made when reflecting on the CVF. The first is that the different categories are not discrete, but rather reflect dominant forms for culture.⁶⁷ In reality, organisations might encompass aspects of each form accordingly. The second is that cultures are non-static. Importantly, therefore, while an organisation might identify a dominant form, cultures change over time. Incremental changes might be made in the implementation of strategy, while more radical changes are often necessitated when adopting a strategic direction that is markedly different to what currently exists.⁶⁸ Effective cultural change requires the commitment and involvement of leadership of the organisation.⁶⁹ Here particularly, leaders should ensure that culture changes and is redefined in accordance with changes to the strategic direction of the organisation, mission, values, as well as competencies.⁷⁰ This is a dynamic, ongoing process, such that as the organisation transitions from an old to a new culture, organisational leadership should already be aware of and sensitised to the necessity for potential future change.⁷²

Figure 13.14 Conflicting Values Framework (CVF) depicting culture types and corresponding leadership approaches⁷¹



13.3.8.3 The importance of organisational values

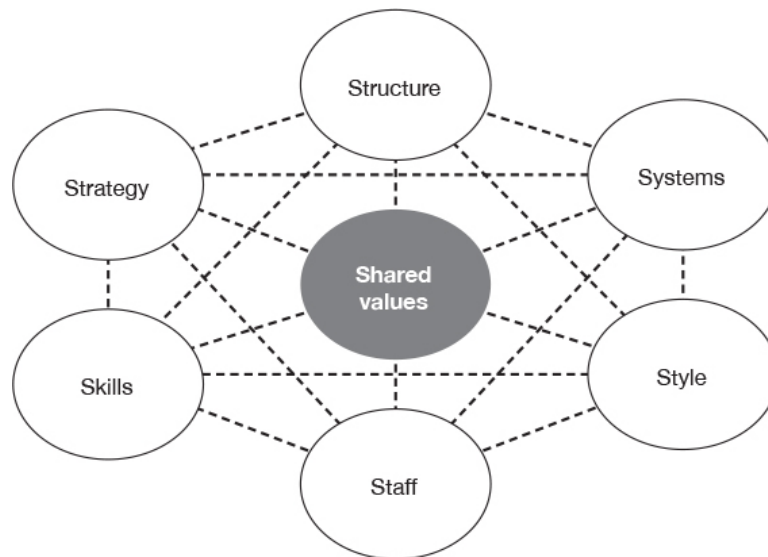
In [Chapter 3 \(section 3.5\)](#), you were introduced to the notion of the 'value statement'. Values, as was stated in that chapter, are a central consideration of culture since they 'form the glue that binds an organisation's culture'.⁷³ An organisation's values may contribute significantly to its success.⁷⁴ This is because values will 'eventually affect the way customers are perceived and treated, the way employees and their contributions are viewed and rewarded, and the way in which the future is anticipated and managed'.⁷⁵ Having the 'right' values will therefore have a significant influence on the way in which an organisation reacts to the environment, and therefore shapes and implements strategy.

But what are the 'right values'? Peters and Waterman identified eight attributes as being germane to highly successful and excellent organisations and from which organisational values are derived.⁷⁶ These include:

- *A bias for action*: Being driven and getting things done
- *Being close to the customer*: Demonstrating a commitment to customer satisfaction and superior service
- *Autonomy and entrepreneurship*: Fostering a climate of risk taking and innovation
- *Productivity through people*: Understanding human resources as a true asset and therefore as a source of quality
- *Being hands-on and values driven*: Overarching management philosophy that see leaders acting as role models through commitment
- *Sticking to the knitting*: As an organisation, focus on what you do best
- *Simple form and lean staff*: Encouraging dispersion of authority through joint decision-making and participation
- *Simultaneous loose-tight properties*: Simultaneous control and planning while allowing for worker autonomy.

Importantly, several of the different architectures discussed in [Table 13.2](#) point to the relevance of values in strategy alignment and implementation. By centrally locating values, for instance, Peters, Waterman, Pascale and Athos,⁷⁷ in developing the McKinsey 7S Architecture, pointed to the critical role that values play in shaping all other elements of their model, and arguably, therefore, in shaping organisations in general (see [Figure 13.15](#)). It is these values or core beliefs that provide guidance and shape thinking, particularly during times of crisis.

Figure 13.15 The McKinsey 7S framework⁷⁸



13.4 Summary

In this chapter, we discussed the role of organisational architecture in aligning the internal organisation for more effective strategic implementation and execution. As a strategic tool, the concept of organisational architecture has gained much currency, particularly over the past decade. Essentially, organisational architecture is an integrated strategic response that draws together key dimensions of the organisation (such as culture, KSAs, structure and systems, policies and procedures, and processes) used to guide strategic implementation. The value of an organisational architecture lies in its ability to integrate and align the organisation in such a way that strategic attainability is achieved.

We used Lee et al.'s architecture to guide discussion on organisational architecture. The value of this particular model is that interrelationships between key pillars of the architecture are illustrated using a process approach. We discussed each of the pillars that reflect the core dimensions of the internal organisation in turn throughout the chapter.

REFLECTION BOX:

Thus far, strategic alignment has been examined within the corporate context. However, it might well have a more immediate impact on our day-to-day lives. Consider, for instance, the fact that government is at times accused of under-delivery, and in some departments under-expenditure, which in South Africa has repercussions for poverty alleviation in particular. How applicable and effective do you think strategic alignment through the adoption of an organisational architecture might be in addressing this challenge?

Opening case study questions

1. Based on the Opening case study, how do you think the natural world could be usefully applied to how organisations should be structured?
2. What are the similarities between the principles underscoring organisational architecture, and those that relate to the notion of the 'superorganism'?

Discussion questions

1. Discuss the concept of organisational architecture. In so doing, list and briefly compare the various architectures before describing how they might assist in strategic alignment and implementation.
2. Briefly differentiate between the Newtonian and chaordic paradigms as ways of viewing organisations. Can you think of different metaphors for these paradigms that you could apply to an organisation? For example, the organisation is like a ship. Explain how you would relate the metaphor of an orchestra and then of a jazz band to the organisation.
3. How is organisational structure key to strategic implementation?
4. Organisational processes are sometime seen as being synonymous with excessive bureaucratisation, yet processes are also key to strategic implementation when properly implemented. To your mind, what are the salient differences between bureaucracy and good process, and how can process facilitate strategic implementation?
5. De Toqueville stated: 'In proportion as the principle of division of labour is more extensively applied, the workman becomes weak, more narrow minded and more dependent.' Do you agree with this sentiment? In reflecting, refer to the relative advantages and disadvantages of a high degree of division of labour.
6. Fully discuss the usefulness of Lee et al.'s architecture in addressing strategic alignment. Here you might want to use an example. Try to go beyond the HIV/Aids scenario used in the chapter.
7. Values are a central tenet of most organisational architectures. Why do you think this is? Fully motivate your answer.
8. What are the key elements of a culture that supports strategic alignment? Fully describe each element.

Using knowledge and skills

1. Identify and visit a small business of your choice. Investigate by means of an interview with the CEO what key success drivers are to strategic implementation, as well as what deters effective implementation. How could this information be used to compile an organisational architecture?
2. How important is delegation of authority to effective decision-making? Discuss this with someone who is in a managerial position in an organisation.
3. Together with a colleague of your choice from your class, develop a presentation of 10–15 PowerPoint slides outlining the importance of organisational architecture in strategic implementation.
4. Transformation is the current imperative of most higher-education institutions in South Africa. Try to acquire the strategy of the institution at which you are studying (in many instances, this may be readily available on the institution's website) and propose how organisational architecture might be used to achieve the institution's vision.
5. The effective management of HIV/Aids in the organisation is just one issue which might benefit from the application of Lee et al.'s architecture. By speaking to someone you might know in a managerial position, identify any other issue which might benefit from 'greater strategic and integrative integrity'. Through additional research, fully describe the issue before using Lee et al.'s architecture to describe how greater alignment might occur.
6. You and your team have recently been short-listed as a group of management consultants to pitch for a major contract with South Africa's public broadcaster to realign the organisation strategically, following significant challenges it has faced of late. Develop a 15-minute pitch using PowerPoint slides in which you illustrate how you will achieve greater alignment using any architecture of your choice. To complete this activity, you will need to research some of the challenges faced by the SABC, and how these might be overcome through greater alignment.

Further reading

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Suggested websites

- Galbraith Management Consultants (<http://www.jaygalbraith.com>) – Considered the world's leading expert on global organisation design
- McKinsey & Company (<http://www.mckinsey.com>) – A global management consulting firm that advises the world's leading businesses, governments and institutions
- Palladium (<http://www.bscol.com>) – Helps organisations execute their strategies by making better decisions
- MC3 Consulting (<http://www.mc3consulting.com>) – Nihilent's Enterprise Transformation Practice partners with clients in successfully translating business strategies into definitive business results by enabling a culture of learning, innovation, collaboration and performance

Interview with Marc Beinfoff (<http://www.endeavor.org/blog/marc-beinfoff-keynote/>) – Marc Beinfoff evolved V2MOM, which is a cornerstone of [Salesforce.com](https://www.salesforce.com), ranked as one of the most innovative companies in America

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CHAPTER 14

Strategic risk management

Sandra Perks

LEARNING OUTCOMES

After reading this chapter, you should be able to:

- describe what strategic risk management is and why it is important
- explain the role and application of strategic risk management
- explain the steps in the strategic risk management process
- demonstrate an understanding of how to go about risk identification, evaluation and prioritisation
- expound on the four types of risk treatment strategies
- understand the requirements necessary for developing risk management systems
- explain how risk management strategies, policies and action plans are developed
- explain the problems associated with implementing risk management policies and action plans in organisations, and how to overcome them
- explain why it is necessary to continually review and improve risk processes
- assess strategic risk management practices in a practical setting.

KEY TERMS

risk appetite

strategic surveillance

In the last decade, South African Airways (SAA) has frequently made news headlines. The airline has attempted several turnaround strategies, seemingly with little success. Read the Opening case study below to uncover the causes for this.

OPENING CASE STUDY



The SAA turnaround story¹

SAA celebrated its 84th anniversary in 2018 as one of the oldest airlines in the world. The Group operates a dual-brand airline model, with SAA as its premium brand and Mango targeting the price-sensitive market. It also operates a cargo division (SAA Cargo) and has three other subsidiaries, namely aircraft maintenance, repair and

overhaul (SAA Technical); in-flight catering (Air Chefs); and retail travel franchises in southern Africa (SA Travel Centre). As a Star Alliance member since 2006, the vision of SAA is to be an African airline with global reach underpinned by integrity, high standards of safety, valuing its people, and being customer focused and accountable. The airline operates one of the most technologically advanced aircraft fleets in the world with the introduction of the Airbus A330-200 in 2011, two Airbus A320s in 2012 and an Airbus 330-300 in 2016. It offers an exclusive and highly rated product with an international network to all continents from South Africa through 11 direct routes and 22 code-shares. Many leading airlines are customers of SAA Technical, the largest and most advanced maintenance provider on the African continent.

However, the airline has been struggling financially, and in the last decade attempted nine turnarounds for sustainable operational and financial success. These attempts seemed to focus more on obtaining operational efficiency, such as a tap-and-go mobile check-in and self-boarding in London with biometric (facial) and passport recognition, and the introduction of tablet-driven in-flight entertainment on its longer African routes. SAA has also managed to keep its four-star airline ranking for the 16th consecutive year by the independent global airline rating organisation, Skytrax. However, in spite of implementing all these operational efficiency measures, SAA has still not been successful in its latest turnaround strategy, possibly due to the way in which strategic risk management is implemented.

According to the King IV Report on Corporate Governance, a risk management plan should be included in the strategic plans of South African companies. SAA's board is responsible for risk management governance, and an external service provider conducts internal audit spot checks on the effectiveness of its risk management framework and compliance risk areas. Enterprise risks were identified in terms of the extent of impact, probability and the severity of the event occurring using a five-by-five Risk Assessment Matrix for both financial and non-financial elements. Strategic risks were identified, analysed and evaluated with regard to legacy issues in terms of risk profile, procurement and human resources.

In 2017, the new CEO, Vuyani Jarana, announced the following eight-step turnaround plan for SAA to address the weak financial status:

- Possible staff retrenchments through an analysis of the aircraft:staff ratio
- Becoming more competitive by increasing the fleet and providing more passenger comfort on long flights
- Regaining market share lost to Europe by opening more direct flights as new routes
- Re-establishing the international services from Cape Town International Airport and adding other new routes
- Together with SA tourism, offering package tours, multicity stops and integration of regional destinations, and conducting joint marketing by offering two-centre packages with other African countries
- Reconsidering the international flight luggage limitations of only one piece weighing 23 kg
- Addressing staff morale and offering efficient service
- De-politicising the airline to prevent shady tenders or contracts.

Performance management is critical for the long-term retention of SAA's employees, and crucial for the continued existence of this airline. Performance management systems comprising of setting targets and standards, employee development and periodic competency-based appraisals were implemented for both management and non-management employees. In striving towards sustainability, key performance indicators (KPIs) are set at the beginning of each year by management and shareholders to monitor SAA's performance against the predetermined objectives. These KPIs are reported on a monthly and quarterly basis, and regular feedback sessions are held with shareholders. However, meeting the KPIs often results in SAA having to adjust them due to unforeseen market and economic conditions, which points to either not having good risk management strategies, or not ensuring that they are implemented timeously, although the airline has established several committees to oversee risk management. It is acknowledged that politics in South Africa also play a role in derailing good risk management strategies. Of concern is that there is no evidence of the airline managing its risks, and it seems to regard its problems as only financial in nature, judging from the several large bailouts from government over the past decade. Obtaining funding is a short-term solution to SAA's problems, but identifying strategic risks and addressing them purposefully can turn the airline around. Doing so will improve its competitive position and assist it in addressing changing passenger demands. Jarana acknowledged this at the 74th annual general meeting of the International Air Transport Association (IATA) in Sydney in 2018, by indicating that SAA is now in the phase where it has to refine its strategy to tackle cleaning

up the supply chains and cutting down on cost procurement spending, with inevitable job losses to curb expenses. Jarana stated that '[t]he current operating base is not sustainable for the airline. We have to take hard decisions regarding people and the supply chain. Job losses will be inevitable, even though my priority is about job preservation by finding ways to find opportunities for our excess pilots and cabin crew to soften the impact'. However, a three-year period is needed to turn the company around. Jarana further indicated that '[t]here is R9.2 billion of existing debt owed to banks – debt I inherited when I took over as CEO. Then we also need R12.5 billion of working capital to take SAA to the breakeven point. So, in total we need R21.7 billion to fund the existing debt and to fund the working capital needed to get to the breakeven point'.

Overview

There is a strong correlation between strategic business performance and risk management. Performance measures should capture business performance at both current and future levels. An organisation may do well at an operational level, but struggle to grow as competitors can easily imitate it. Strategic business performance requires articulating the business vision and formulating strategies. Although many organisations engage in regular strategic planning, they often do not foresee all the risks that can derail the effective execution of their intended strategies. Successful strategic management is thus dependent on how well an organisation can determine and manage their exposure to risks. Robust risk management is necessary to ensure operations are as effective and efficient as can be. What complicates risk management is that decisions that affect one risk can have a direct impact on risks elsewhere.

This chapter commences with putting strategic risk management in context by indicating the important role it plays in effective strategic management, then discusses the risk management process by explaining each step in detail. The chapter also describes the impact risks can have and how they should be considered when formulating risk management systems, strategies, policies and action plans. The chapter concludes by taking a look at the importance of monitoring and improving risk management performance.

14.1 Introduction

From the Opening case study *The SAA turnaround story*, we can see that SAA has been following several turnaround strategies in the last decade, and acknowledges the role that management can play in securing sustainable operational and financial success. In its pursuit to turn SAA around, the company has identified its business risks and set key performance sustainability targets. However, as SAA has repeatedly requested financial bailouts from government, it seems as though it has failed to effectively manage its **strategic risks**.

We can define strategic risks as those risks that can hinder or assist the organisation in achieving its long-term goals. They must be managed, which brings us to the notion of **strategic risk management**. Strategic risks contribute most to the destruction of value in businesses (86%) but take up only 6% of the time of corporate audit departments.² This can emanate from many different sources, such as competitive activity, new technologies, new regulations, political events or social changes.

Operational risks, on the other hand, are losses caused by employees, or as a result of inadequate operational procedures, systems or controls in place.³ Strategic risks require strategic responses, such as innovation, the development of new organisational capabilities, or the development of new markets, whereas operational risks require operational responses, such as better procedures, systems or rules.

Strategic risk management is the continuous process of identifying and determining the extent of strategic risks, and putting in place strategies that reduce or eliminate risks that may influence the business strategy, objectives and implementation of strategies. Implementing risk management policies and plans in conjunction with the intended strategies planned for the organisation is essential for business continuity.

Strategic risk management requires that organisations determine their **risk profile** and **risk appetite**, and then implement risk control systems based on the impact, frequency of occurrence and vulnerability of the organisation to the risks. Risk profile refers to the threats an organisation is facing and determining their possible impact on the organisation.⁴ Risk appetite is the amount of risk an organisation is prepared to take to meet its strategic objectives.

The discussion that follows explores these preceding concepts in greater depth.

14.2 Strategic risks in context

In the workplace, all decisions involve risks, whether they are daily or strategic long-term ones. Although there are many definitions of risk, the most well-known is the definition of ISO 31000 that defines risks as the effects (positive, negative or deviation from the expected) of the uncertainty of achieving objectives brought about by a change in circumstances or consequence.⁵ Strategic risks are addressed at corporate level by the board of directors and managers as it affects the long-term performance of the organisation and its continuity.⁶ On the other hand, strategic risk management encompasses the processes, methods and tools to identify and manage potential events that may prevent the organisation from achieving its intended objectives.

As can be seen in the Opening case study about SAA, the company has met its non-financial performance targets of ensuring that its flights take off on time and providing the best all-round service to customers. This was evident from retaining their four-star airline rating. AirHelp, a technology company that provides legal services to airline passengers who experience booking problems, has ranked SAA the fifth-best airline in the world (based on delayed flights and booking problems).⁷ Their rating criteria include quality of amenities, on-time arrivals and speed of claim processing. SAA would not have been rated this high if the airline had not deliberately set key performance targets and actively monitored its operations to identify gaps between targets set and performance. It could be argued that it managed operational risks quite well, but the same cannot be said for its strategic risk management, as external market factors, in conjunction with political interference in internal issues, impacted the success of its turnaround strategies. In 2017, the newly appointed CEO of SAA, Vuyani Jarana, changed the focus of the turnaround strategies from being merely performance driven to focusing on risk management. However, it remains to be seen if any significant changes will take place in 2018 in the company's quest for sustainability and whether the different risk management committees will assist in affecting a successful turnaround.

Globally, organisations are faced with increasing volatility, uncertainty, complexity and ambiguity (often referred to as VUCA). As an organisation grows, so does its exposure to risk increases. The strategic risk identification process entails the identification of strengths and weaknesses, and the opportunities and threats in the external business environment. Studies of large public companies indicate that declines in market capitalisation can be accounted for by strategic risks (about 60%), operational risks (30%) and financial risks (only about 10%).⁸ Operational risks must not be confused with strategic risks. Operational risk management means that the organisation is avoiding risks by doing things right, while strategic risk management refers to doing the right things. An example of operational risk is an organisation not appointing the most skilled sales staff because it wants to lower its salary cost. The consequence of this is that it may limit its sales potential but will not lead to the business closing. The organisation must thus weigh up sales potential with salary cost. The unbundling of Eskom, an electricity provider in South Africa, into two separate entities (one for generation and one for distribution) can be regarded as a strategic risk if Eskom's leaders do not think carefully about following the right procedure and putting in place the right systems and processes to operate as two separate entities. Although the electricity provider will operate as two entities, the future existence of the distribution entity will rely on the generation entity taking the correct actions. Incorrect actions by the generation entity could threaten the distribution entity's existence.

The continuous emergence of new risks complicates risk identification, and requires organisations to continually review their risk management strategies and action plans. This means that they must determine their risks and find a

way to manage them to achieve their business objectives. When setting business objectives, organisations must think and plan strategically in order to manage risk, which means that strategy formulation and setting risk strategies must take place simultaneously. The following operational risk example will show an organisation revisiting its strategy due to the arrival of a new risk, and the planning involved in dealing with this.

CASE EXAMPLE: Strategic risk strategies

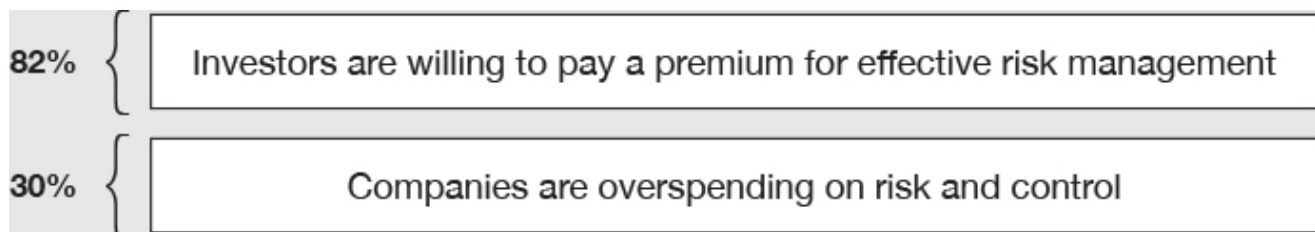
Up until 2016, the possibility of academic activities at higher education institutions stopping because of student protests for free education was inconceivable. However, during 2016 all institutions faced difficulties in completing their academic year due to student unrest. In 2017, there were again academic service delivery disruptions at some institutions. It is very likely that this problem will occur again every year until free tertiary education is offered. As this is not yet available for everyone, contact institutions have to revisit their strategy to offer only face-to-face lectures. If a contact institution's revised strategy entails offering a mixed tuition system (contact and online), it will be able to mitigate the risk of disruption and ensure continuous service delivery. When protests disrupt classes, the institution will manage the risk by offering online tuition during such periods. However, this operational risk can only be managed if there is an e-learning platform before the risk occurs, so the necessary infrastructure and organisational structure must be in place. Implementing the use of an e-learning platform will also require planning on how to avoid the risks associated with access to the platform and its functionality.

As can be seen from the example, dealing with the problem of academic disruptions requires institutions to revise their strategic risk strategies. The institutions also need to consider the problems that might occur with executing a new risk strategy. In other words, changing from purely contact tuition to mixed tuition will require attention to be given to managing the operational risks associated with the e-learning platform, for example not being fully operational, accessible or cost effective. As institutions cannot foresee all the risks and problems that may occur, risk management must be a continuous process.

Risk management helps organisations to understand, manage, communicate and prevent unfavourable conditions that may threaten the survival of the organisation. It is therefore clear that investors and managers alike would view risk management as an important function of an organisation.

CASE EXAMPLE: Risk management

In a report by Ernst & Young,⁹ it was indicated that:



This shows that many organisations are serious about risk management, and that some are even overspending on it rather than not having control systems in place. It is obvious that they realise the potential consequences of ineffective risk management.

How organisations should go about the managing strategic risk will be discussed in more detail in the sections to follow.

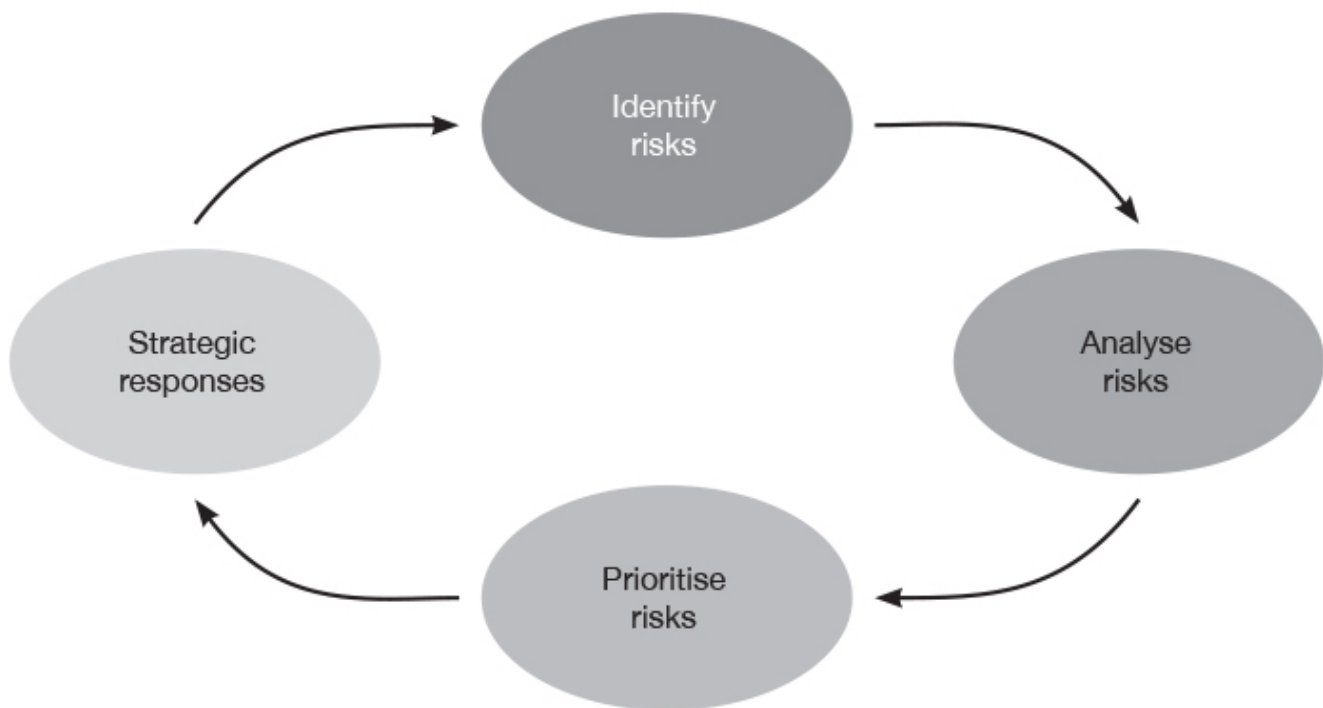
14.3 Managing strategic risks

Managing strategic risks is about considering how changes in the internal business environment could influence the strengths or weaknesses of an organisation, could pose opportunities or threats to the organisation, and what the organisation could do to mitigate these risks. Organisations do not just monitor the business environment, but also anticipate or react to changes taking place in the internal and external business environment. The environment presents many risks, but organisations have limited resources and cannot give the same level of attention to all of them. For that reason, it is important for organisations to apply the risk management process so that they can focus their attention on the most important risks. In the first phase of risk management, the organisation identifies potential strategic risks in the external and internal environment by examining the macroenvironment (see [Chapter 5](#)), the industry environment (see [Chapter 6](#)) and the internal environment (see [Chapter 7](#)). The second phase requires the organisation to analyse risks and to develop an understanding of the likelihood of them occurring, and the potential impact on the organisation if they do. This analysis enables the organisation to evaluate, compare and prioritise risks, so that it can focus its efforts on the most important ones by making strategic decisions about how to respond to them. For example, if a financial risk is posed by investing in new robotic technology at a motor manufacturer, the benefits of obtaining the new technology should be carefully weighed against the financial investment required by considering how quickly the technology could be outdated. Organisations can respond to risk by deciding how they want to deal with it.

The implementation of a risk management plan is of the utmost importance in ensuring that the intended strategic outcomes occur. The intended outcome of risk management is to reduce or eliminate the risk of some events from occurring, or reducing the impact on the organisation if they do. The idea behind risk management is to protect the organisation from being vulnerable by acting responsibly. The benefits of engaging in risk management are many and various, as threats can be minimised and opportunities seized. The strategic risk management process is influenced by the organisational architecture, which includes the leadership and culture of the organisation, the systems it uses and the structure of the organisation. For example, organisational cultures that are risk averse (i.e. that have a lower [risk appetite](#)) will deal differently with risk than those with higher risk appetites. The type of business influences how it views potential changes in the business environment and the extent of its risk appetite. For example, a labour-intensive organisation will not regard legal changes to digital marketing as a high business risk but will regard any labour law changes as such. The process of strategic risk management is depicted in [Figure 14.1](#).

Figure 14.1 Strategic risk management process

Organisational architecture



To help an organisation monitor which risks occurred and whether the measures it adopted led to the intended outcomes, it is necessary to keep a **risk register**. This should record details about the reason(s) for deviation from the intended strategy, the action implemented to counteract risks, and how effectively and efficiently the procedures took place. Keeping a good risk register could enable an organisation to make better future risk assessments and implement better risk management controls.

Risk management should involve staff at all levels, which requires good communication between and among the different hierarchical levels. A discussion of the information contained in the risk register can create a culture of learning from mistakes, and develop the ability of staff to identify risks better. It also encourages accountability without putting the blame on staff. Monitoring risk performance also requires good performance reporting. In South Africa, it is mandatory for listed companies to follow the King IV Report on Corporate Governance, and publish their triple bottom line performance results.¹⁰ External performance reporting provides all stakeholders with information on many aspects of an organisation's sustainability, and on how it is dealing with risks threatening its sustainability.

The benefits of risk management lie in building stronger organisations through selecting sound strategies for resilience, which in turn lead to achieving objectives, increasing competitive advantage, improving the image of the business, enhancing business performance, fast-tracking the organisation towards sustainability, and better sustainability reporting.

Risk management is not a once-off process but requires continuous scrutiny of the environment for changes by obtaining and sharing information internally and externally between and within management levels. However, as with all business actions, the cost of managing risks should be considered. The proliferation of data, due to internet access, has lowered the cost of access to data considerably. The organisation should consider the level of risk associated with the type of products or services that it offers, the size of the business, and the complexity of the organisational structure, as these things influence the range of risk management strategies that will be necessary. In the next section, we consider some aspects of implementing strategic risk management. The strategic risk

management process should also provide the organisation with a deeper understanding of the risks associated with the implementation of strategies. A detailed discussion of the risk management process follows.

14.3.1 Step 1: Risk identification

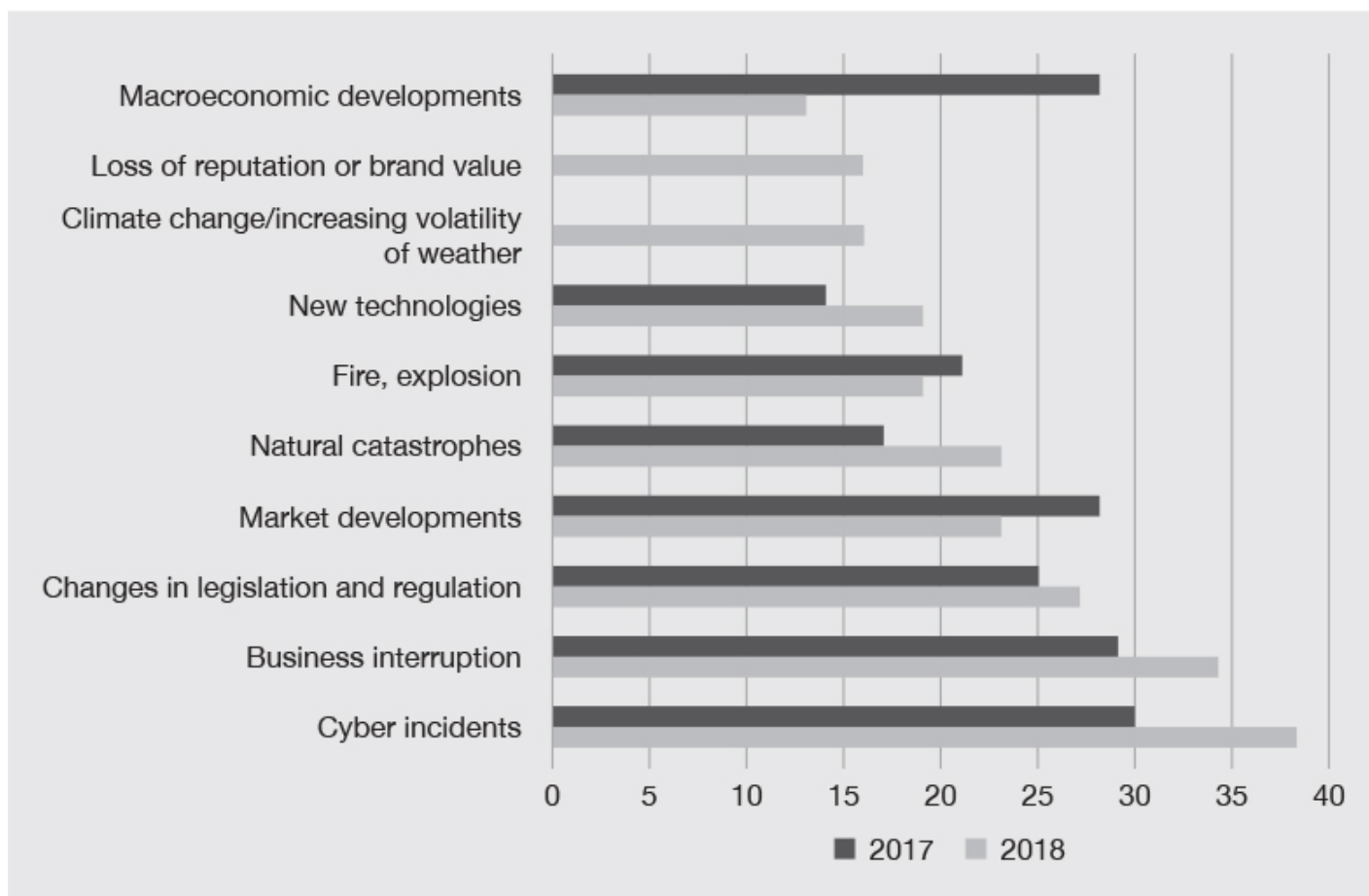
The first step in the strategic risk management process is to identify and assess risks with an open mind by focusing on current and future events. Risks can be identified from various sources. They can come from data collection processes such as market research or competitive intelligence. **Competitive intelligence** refers to the processes and practices that produce and disseminate actionable intelligence on the internal and external environment to advance strategic decision-making by ethically and legally collecting, processing and analysing information.¹¹ Risk brainstorming by experienced employees with the right expertise is of cardinal importance in identifying and assessing risks. Organisations can also contract external consultants to assist in identifying and assessing all possible risks. Risk identification is about determining which changes in the internal and external business environment could influence the strengths or weaknesses of an organisation, and could pose opportunities or threats to it. It thus requires constant environmental scanning or **strategic surveillance**. Environmental scanning or strategic surveillance requires the organisation to monitor the business environment and organisational resources to identify threats or opportunities for the continual existence of the organisation.¹² The level of environmental scanning will differ depending on the business size and how diversified its operations are. For example, airfare pricing at SAA and other airlines depends on taxes and changes to regulations, so airlines continuously scan the business environment for such changes.

There is much uncertainty about changes in the general and industry environments, and the future actions of competitors and customer preferences. This uncertainty shapes the internal and external business environment as they are interrelated. In other words, an external business environment change can influence the internal business environment of an organisation. Managers are often in conflict about how they will deal with business environmental changes. To avoid management conflict, a systematic approach to identifying all threats, risks and events that may influence the intended strategies and objectives of the organisation must be followed. These risks could originate internally or externally. It is, however, easier for an organisation to plan for internal risks as they are within their control. External risk assessment is always more difficult as the risk originates from outside the control of the organisation.

One of the ways to identify risks is through brainstorming and creating 'what if' scenarios during strategic planning meetings. Technology facilitates the availability of information through access to flow charts, system design reviews and operational modelling. As organisations cannot always fully comprehend the extent of the impact of an environmental change, many use specialist risk management software to assist them in assessing the extent of the impact of an environmental change. Organisations also rely on being made aware of environmental changes announced in public sources, such as newspapers, television or the internet, with information on how it might affect their organisations.

In South Africa, the following 10 business risks, shown in [Figure 14.2](#), were identified by Allianz Global Corporate and Specialty in their Alliance Risk Barometer report for 2017 and 2018.

Figure 14.2 Top 10 business risks in South Africa (2017–2018)¹³



As can be seen in [Figure 14.2](#), the two main risks identified in both 2017 and 2018 – cyber incidents and business interruption risks – remained unchanged. On the 2018 top 10 list, climate change/increasing volatility of weather and loss of reputation or brand value were newly identified risks. Participants in the study felt that the probability of risks occurring, excluding market developments, fire/explosion, as well as macroeconomic developments, have increased in South Africa since 2017.

Some risks could lead to significant social and economic losses for people, organisations, the government, regions and even countries. In the Strategy in action case *Tiger Brands hurt by listeriosis outbreak*, we examine the possible consequences of the largest global outbreak of listeriosis, with 180 confirmed deaths in South Africa and almost 1 000 laboratory-confirmed cases at the time of writing.

STRATEGY IN ACTION: Tiger Brands hurt by listeriosis outbreak¹⁴



On 2 February 2018, officials of the South African Department of Health and members of the National Institute for Communicable Diseases visited the Polokwane-based Enterprise Foods factory and took over 400 environmental swabs and nine product samples to test for the listeriosis disease after children who had eaten polony became sick. Enterprise Foods has a 25% share of the country's processed meat trade and is part of Tiger Brands. Although the company took their own samples on 3 February and these tested negative for listeria, low levels of the listeria strain were found in one of its products on 14 February. The company quarantined all affected products and recalled products that had been sent to shops. It is very difficult to trace the strain as one slice of polony can test negative, while in another slice there may be traces of the bacteria. On Monday 19 February, the National Consumer Commission ordered a national recall of Enterprise frankfurters, smoked Russians and polony as 16 samples of food products tested positive for the ST6 listeria strain. This resulted in

the shutdown of all their operations at their facilities in both Polokwane and Germiston, and the recall of these products at all retailers supplied. Customers were also advised to wash their fridges with diluted bleach if they had stored any of the products. Rainbow was also instructed to recall all their chicken viennas after a different strain of listeria was found at their Wolwehoek plant, which they immediately did. Although Enterprise undertook cleaning protocols in all its facilities, halted supplies to retailers, and set up a consumer helpline, the company refused to take the blame for the deaths caused by listeriosis. Since the announcement of the cause of the outbreak, Tiger Brands shares fell to their lowest level since December 2015 and traded 6.6% lower. It is anticipated that South Africa could also see one of the biggest class-action lawsuits by families of those who contracted listeriosis.

Questions

1. How would you classify this type of risk?
2. In your mind, do you think Enterprise Foods had an appropriate risk management strategy in place? Motivate your answer.
3. Do you think Enterprise Foods is managing their risk performance well? Motivate your answer by indicating what they could have done when discovering that there was a problem at the plant.

As illustrated in the Tiger Brands Strategy in action case above, risks affecting organisations can have dire consequences for economic performance and professional reputation, as well as environmental, safety and societal outcomes. Again, as the Tiger Brands case shows, not all risks can be foreseen. Few organisations are entirely successful in analysing their business environment effectively, as scanning often reveals incomplete and unconnected data and information. In addition, the business environment affects organisations differently, depending on their financial position and resources. For this reason, it is important for organisations to evaluate and prioritise their risks so that they can focus their efforts on the most severe threats.

14.3.2 Step 2: Risk analysis

The listeriosis outbreak shows how important it is for organisations to assess their risk profile. The risk profile of an organisation can be assessed according to:¹⁵

- the impact on physical assets, staff and the finances of the organisation (varying from low to extreme)
- the likelihood of the occurrence linked to its probability and frequency (varying from frequent to rare)
- vulnerability to risk (very high to very low).

Figure 14.3 An example of risk impact classification¹⁶



The severity of the risk determines the impact classification. More attention is required when a risk is classified as extreme rather than incidental. In addition, risks must also be assessed in terms of frequency and likelihood of occurrence. When a risk is assessed in terms of likelihood, it could be classified as:

- frequently occurring
- likely to occur
- possibly occurring
- unlikely to occur
- rare.

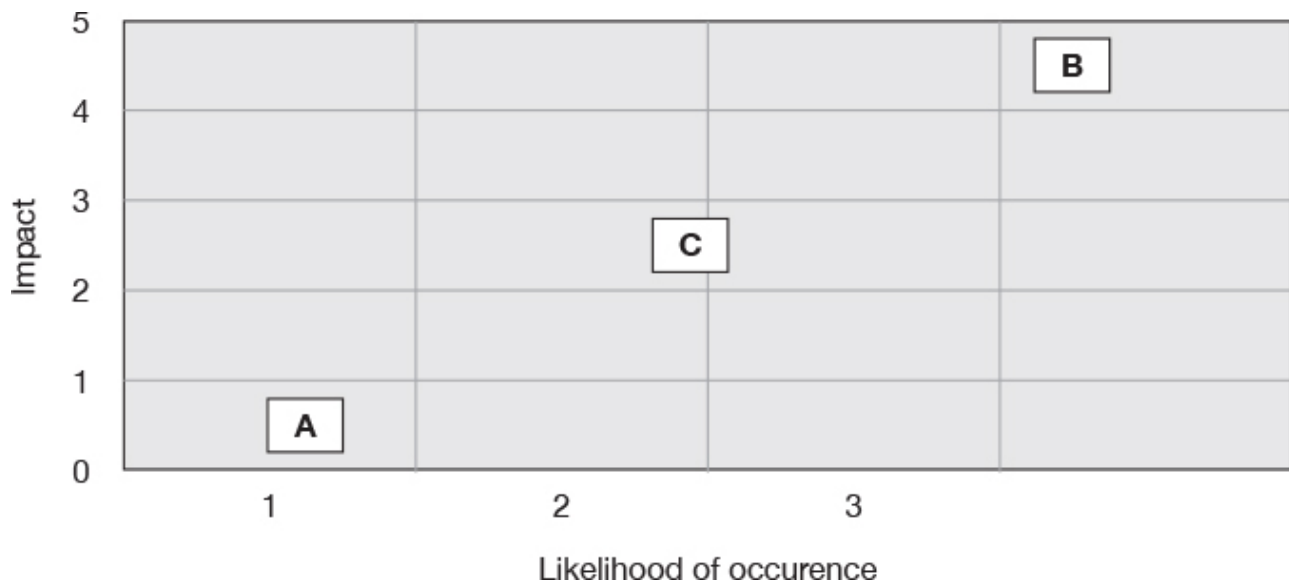
The frequency is associated with the number of occurrences within a specific period, such as only once in three years or once a month. In the next paragraph we examine some examples of risks that were assessed according to frequency.

The most difficult and complex risk to assess is an information security risk as it is a forever-changing business environment. An information security risk will thus be classified as frequently occurring. In contrast, it is difficult to predict at recruitment stage how long an employee will remain employed by an organisation. This type of risk will therefore most probably be classified as possibly occurring. The personal financial situation of an employee may change if another member of the family loses their job. This may affect an employee's loyalty to the organisation and could result in their selling confidential information to competitors to keep the family afloat. This type of risk may

be classified as rare. Note, however, that the frequency or likelihood of an event does not indicate the impact on the organisation; for example, even though a risk may be rare, it could have an extreme impact on the organisation.

To determine the likelihood of a risk occurring, the organisation can analyse how many similar cases have taken place over several years, but even that will not result in a precise forecast. The likelihood of occurrence is normally linked to a percentage (e.g. if almost certain to occur), it could be said to have an 85% probability of occurrence. Most often, organisations draw up a risk matrix in terms of a combination of the impact and likelihood of a risk occurring, as seen in Figure 14.4.

Figure 14.4 Matrix of risk likelihood of occurrence and impact¹⁷



The classification of the points on the matrix can be explained as follows:

- Risks in the bottom left corner (A) are incidental (rarely occurring) and have a low impact (1, 0).
- Risks in the top right corner (B) are frequently occurring and have an extreme impact (3, 5).
- Risks in the middle of the matrix (C) are infrequently occurring and have moderate impact (2, 3).

Risks in the bottom left corner (A) can often be ignored, while those in the middle of the matrix (C) should be reduced and those in the top right corner (B) are of critical importance and should be prioritised. The likelihood of a product line disruption when equipment is old is high, and so is the organisation's dependence on basic utilities such as water and electricity. On the other hand, the likelihood of severe earthquakes in southern Africa is low.

14.3.3 Step 3: Risk prioritisation

The conditions in which a risk takes place plays a role in determining how vulnerable an organisation will be to it. The vulnerability should be considered in terms of how prepared, agile and adaptable the organisation is to manage the risk if it occurs. If a risk is certain and may prove to be fatal to the existence of the organisation, it should obviously be prioritised. For example, a large-scale earthquake occurring in South Africa that causes the collapse of an organisation's building as well as the death of many employees would be detrimental to the survival of the organisation. One would therefore think that this risk should be prioritised. However, the likelihood (certainty) of a large-scale earthquake occurring in South Africa is low and therefore perhaps it is not necessary to prioritise this risk. The more vulnerable the organisation is to the risk, the greater the potential consequences. This can be assessed as:

- high vulnerability (essential to attend to)

- medium vulnerability (to be monitored)
- low vulnerability (to be observed).

Think here of cricket matches that depend on favourable weather conditions. In South Africa, we are fortunate to have long summers with many days of sunshine and clear skies (especially in the Western Cape, which is a winter rainfall area). However, in England, weather is a major consideration when planning cricket matches as the country experiences fewer sunny days and more rainy ones in summer than South Africa. Scenario planning for cricket tours in each country will be unique, partly because the climates differ.

Similarly, scenario planning for risks is unique to each organisation. Included in this must be the range of strategies to manage the risks. Control systems to limit a risk from occurring may be required, such as the amount of funding to be set aside to overcome the consequences of the risk occurring, and the team of employees that could assist in managing the risk recovery process. It is therefore necessary to develop effective risk management strategies.

14.3.4 Step 4: Developing risk responses

The final step in dealing with strategic risks is to develop strategies to minimise or eliminate their impact. This phase is also sometimes referred to as 'risk treatment'.

Risk treatment is the process of selecting and implementing measures to deal with risk. Management can use four basis risk treatment strategies, namely risk acceptance, risk avoidance, risk reduction and mitigation of risk:¹⁸

- *Risk acceptance*: This means that the organisation accepts the consequences of risk, and budgets for them. For example, large retailers generally budget for a certain percentage of loss due to damage or theft, while banks may budget for a certain percentage of loans not being repaid ('loan impairments').
- *Risk avoidance*: This means that the organisation reduces its interaction with a risk, for example by selling off a high-risk business area, or not stocking products from certain countries.
- *Risk reduction*: This consists of reducing the negative effects of the risk; for example, retailers may try to manage the possible loss of income due to the effect of online retailing by offering online shopping themselves.
- *Mitigation of risk*: This consists of developing strategies to deal with the risk, transferring it to another party, or sharing it. For example, large retailers will often transfer the risk of damaged inventory or theft to suppliers by levying a fee ('wastage allowances'). Insurers typically take on risk at a fee; in other words, by paying a premium, businesses transfer their risk to insurance companies.

An organisation may decide to accept a risk because it will cost too much to eliminate it completely, or if it assesses the consequences of the risk to be bearable. If an organisation decides to accept a risk, no further action will be required except to allocate funds to manage the consequences or to communicate the risk to staff.

Risk avoidance will require immediate action in order to eliminate the possible exposure to risk. To reduce the risk, actions should be identified, and alternative strategies developed to reduce the likelihood of potential losses if the risk occurs. For example, if an organisation introduces new security measures for their staff's emails, this can reduce the risk of hackers accessing confidential information. The extent of the impact, the probability of its occurrence and the level of vulnerability of the organisation to the risk should be determined to ensure that sound alternative strategies are developed.

Which of these treatment strategies an organisation will implement depends on its level of vulnerability to the risk, and the budget available. If an organisation chooses risk mitigation as a strategy, taking out insurance is often the choice to share or transfer the risk. However, insurance will not reduce the risk, but merely protect the organisation against financial loss in the event of the risk becoming a reality. In other words, the risk will be transferred to the insurer. Some examples of business risks that can be mitigated through insurance include product

liability, fidelity (theft by employees), public liability, business interruption and goods-in-transit. In the Case example below, we consider the risks posed by cyber attacks, and how organisations can deal with them.

CASE EXAMPLE: PoPI Act¹⁹

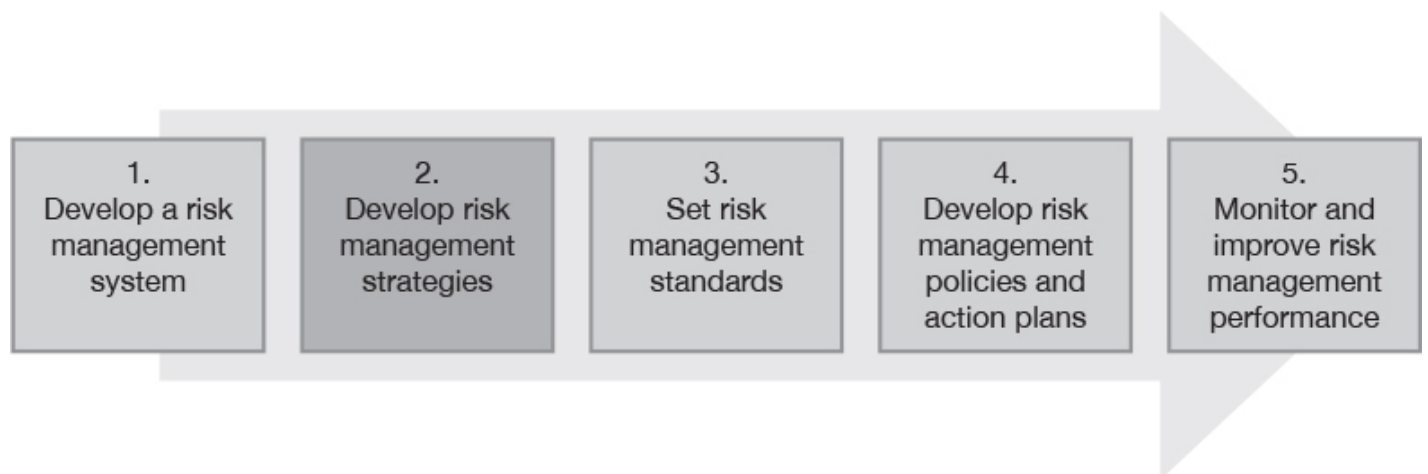
An Information Security Breach survey undertaken by PricewaterhouseCoopers in 2015 showed that 90% of large organisations reported a security breach due to ex-employees, or a cyber attack, and took on average 170 days to detect a malicious or criminal attack. The survey found that 59% of employees steal proprietary corporate data when dismissed, or resigning. It was further found that 68% of funds lost because of a cyber attack were declared unrecoverable. For this reason, organisations must structure work streams or processes and brief their staff on the protection of personal information protocols to avoid it from happening. Management must then develop effective control systems and technologies to ensure compliance and train their employees to raise awareness and understanding of the PoPI Act (Protection of Personal Information Act). It would be desirable for companies to recruit a permanent employee to act as Privacy Officer.

As mentioned earlier in this chapter, strategic risk management is complex, so organisations must think carefully about their risk management processes and systems. We discuss the implementation of strategic risk management in the next section.

14.4 Implementing strategic risk management in the organisation²⁰

Strategic risk management in the organisation is about putting risk identification systems in place that can help the organisation to identify strategic risks, develop risk management strategies, set risk management standards, develop and implement risk management policies and action plans, monitor risk management performance and take action to ensure that the risk management performance improves over time. This process is depicted in Figure 14.5, and illustrated in the Case example *Strategic risk management at Lego Group*²¹.

Figure 14.5 Implementing strategic risk management in the organisation



CASE EXAMPLE: Strategic risk management at Lego Group

Lego is one of the largest and most popular toy manufacturers in the world, growing from a simple manufacturer of wood-based play sets to a conglomerate of plastic toys, theme parks, retail stores, board games and books. Excerpts from an interview with Hans Læssøe, senior director of strategic risk management for Lego, reveals how the toy company deals with risks.

‘I have been given all the time and resources I wanted to develop this [risk management process within Lego]. I have 100% buy-in on processes and tools from the CEO and corporate management. I know the company – I currently have 31 years of seniority – as well as who to talk to for further insights. I keep it simple. If I can’t explain what I do or what I want and why in five minutes, I redo the asking.’

‘We apply strategic risk management in three key approaches for three different things. On strategy definition, we have a scenario-based process where we focus on making management “think the unthinkable” and hence identify strategic issues they would not have seen had they regarded 2018 as an extrapolation of 2013. These issues are then systematically prioritised and embedded in the strategy description. On strategy implementation we have a defined tool and process for active risk and opportunity planning and management, which is mandatory for major business projects, and strategy implementation. On strategy execution, we have a major Enterprise Risk Management (ERM) database where we collect and document risks and their assessments and handling. The database enables us to define an overall risk exposure vs the defined risk tolerance.’

‘At least in the beginning, a lot of people thought it was my job to avoid risks. It isn’t. It is my job to balance risks and opportunities... So, would I approve of a massive project that could cost us \$100 million? Sure, if the upside was sufficiently large and the likelihood of losing sufficiently small. What I will not accept is bulldozing a project without due consideration to the risks and opportunities involved.’

In the next section, we examine the risk management system identification process.

14.4.1 Step 1: Develop a risk management system

Earlier chapters of this book already considered many frameworks and tools that can play a role in the process of identifying a strategic risk management system. [Chapter 4](#) considered the role of strategic enablers in supporting strategic decision-making by, among other things, developing insights and understanding risks. [Chapters 5 to 7](#) examined the frameworks for analysing the macro, industry and internal environments of the organisation. In addition to what is discussed in these chapters, we are going to look at four specific control mechanisms that can, in combination, be used as a risk management system.

Strategic surveillance

Environmental scanning or **strategic surveillance** can be viewed as a means of unfocused control (unfocused because it is not specific to a certain business issue that has occurred). In this control system, the business environment and organisational resources are monitored to identify threats that can impede, or opportunities that can ensure, the continual existence of the organisation.²² In this control mechanism, managers visualise which potential threats and opportunities can affect the organisation, and what impact they might have; in doing so, they do not rely on past occurrences to determine the way forward. Information can be obtained about the internal and external business environment by means of:²³

- reading trade publications, newspapers and articles on the internet
- watching television
- talking to customers
- talking to suppliers
- attending trade shows
- attending conferences
- following social networking sites such as Facebook and Twitter.

This information can further assist the organisation in doing SWOT and PESTEL analyses. Regular workshops or brainstorming sessions with managers is a good way of surfacing their perceptions of the risks facing the organisation.

Special alert risk control

Special alert risk control is another control mechanism, and requires organisations to thoroughly and rapidly reconsider the current strategy of the organisation due to the occurrence of a sudden and unexpected event.

Examples of these events could include:²⁴

- natural disasters such as tsunamis or earthquakes
- chemical spills of, for example, nuclear waste
- terrorism
- plane crashes
- major product defects
- hostile takeovers.

Special alert risks have a very low likelihood of occurring, but can have a devastating impact on an organisation, and even threaten the existence of the entire organisation. If any of these events occur, the existing strategic direction may become obsolete and redundant. Special alert risk control can be applied by formulating contingency risk strategies and assigning the responsibility of handling unforeseen events to crisis management champions and teams. These special control risk systems can assist in detecting crisis signals, which is the first step in managing a crisis. The steps an organisation could follow in a crisis management situation are illustrated in [Figure 14.6](#).

Figure 14.6 Steps followed in crisis management²⁵



As can be seen in [Figure 14.6](#), after detecting signals that there is a crisis, the organisation has to set in motion preventative measures to limit the extent of the damage, or prepare themselves on how they are going to cope with the damage caused. Once the measures have been implemented, the organisation should start to recover. Organisations must sometimes thus learn from one crisis in order to prevent or be prepared for future similar crises. However, one crisis will not be exactly the same as the next as the circumstances and/or timing will differ. The following example illustrates the steps Toyota took when faced with a crisis.

CASE EXAMPLE: Toyota's airbag recall²⁶

In January 2018 Toyota South Africa recalled 730 000 vehicles when they discovered the front airbag inflators produced by their supplier of over 15 years, Takata, were potentially faulty. Moisture intrusion could make the inflators build up an excessive internal pressure when the airbag is deployed and cause the inflator to rupture, with a metal fragment escaping through the airbag material, possibly injuring the occupant. Toyota released a statement warning Toyota owners how to check if their vehicle is affected and to arrange to get the front airbag inflations replaced. They provided a call centre number and email address to which queries could be addressed. Owners could check if they needed to get it replaced by entering their VIN number on the Toyota website. There was also a list available of the vehicle models and release years that may be affected. This resulted in restoring consumer confidence of Toyota vehicle owners and prospective buyers.

Special alert risk control helps organisations to identify those environmental changes that require immediate reaction.

Assumption risk control

Assumption (or premise) risk control is designed to gather data and analyse it systematically and continuously to determine whether the assumptions on which the strategy is based are still valid in the light of new information.²⁷ This type of control rests on premises and assumptions that act as a basis for formulating risk management strategies. A premise or assumption can be the basis of several strategies, or a strategy can be based on more than one assumption. We can therefore regard a premise as a specific constraint. For example, an organisation may base its strategy on importing goods or raw materials from another country at a certain exchange rate. Drastic negative changes in that exchange rate may mean that the pricing of their products will have to change. Price is then assumed to be a constraint for the organisation as, because of the higher price, customers may assume the products are now of a better quality, which is not the case. The consequence may be that customers stop buying the product from the organisation. Assumptions can be made about a whole range of environmental and industry constraints, as illustrated in Figure 14.7.

Assumption risk control requires organisations to incorporate environmental and industry constraints in their control system to predict the business environment landscape over the next three to five years. These constraints then act as baseline assumptions to monitor environmental changes or deviations from strategic plans. It must be noted that not all assumptions/premises require the same amount of control. For this reason, organisations must determine whether the premises are critical or non-critical. For example, a change in the taxation rate for organisations cannot be regarded as a critical premise, as all organisations are affected by it in the same way. Managers must therefore carefully select critical premises/assumptions that are likely to change and would have a major impact on the organisation and its risk strategy.

Figure 14.7 Business environmental and industry constraints²⁸

Business environmental constraints	Industry constraints
• Inflation rate increase • Interest rate increase • Technology change • Government regulations change • Demographic and social changes • Demand reduction • Increased supply cost • Climate change effects	• Competition • Barriers to entry • Substitute products • Number of suppliers available

Assumption risk control is not just beneficial for predicting the business environment landscape when setting strategies, but can be used to revise risk strategies. For example, an organisation may launch an electric car as a new product on the market at a moderate price level, thereby choosing a cost leadership strategy.²⁹ However, the growing demand for electric cars might require them in time to change to a growth strategy. If government provides aid for electric cars up to a certain period (e.g. 2016), the organisation may decide not to continue utilising a growth strategy, but will revert to a cost leadership strategy to cash in on the government subsidy. As the organisation changes its growth strategy, its risk strategies need revision, and different assumption risk controls are then required. The recovery process in formulating new risk strategies when assumptions were incorrect is of utmost importance.

The main purpose of assumption risk control is therefore to identify changes in assumptions timeously and to allow for immediate strategic change if necessary. A major issue in assumption risk control is determining which assumptions and premises should be monitored.

Milestone reviews

Strategic decisions often require big changes and are supported by large and capital-intensive projects. One control technique that could assist in managing the strategic risk associated with such large projects is to conduct **milestone reviews**. A milestone is a control measure to monitor the effective execution of a strategy at various intervals, mostly based on time or cost. Setting a milestone usually involves a full-scale reassessment of the strategy. Milestones are especially significant in the development of a project and implementation of a strategy where large commitments of resources must be made. Failure to meet a milestone signals a warning that the project may be at risk. The organisation can then decide whether to continue with the strategy or, if the assessment of the risk indicates that the risk is too large, change it.

Project milestones are significant achievements in a project, and achieving them (or not) is a good indication of where the project is headed and its impact on the organisation. In the Case example below, we can see how Eskom's Medupi project has exceeded its time and cost targets, creating massive problems for the electricity utility and the country.

CASE EXAMPLE: Eskom's Medupi and Kusile projects³⁰

Eskom's Medupi power station, located near Lephalale in Limpopo province, has been under construction since 2007, while the Kusile power station in the Nkangala district of Mpumalanga province has been under construction since 2008. Both projects have seen massive increases in the estimated cost to completion (CTC) and the estimated time to completion. These project overruns have strained Eskom's financial resources, and placed greater pressure on Eskom's electricity price trajectory in the years ahead.

When Medupi was commissioned in 2007, the estimated CTC approved by the board was around R69 billion. By 2016, this figure reached R195 billion. Similarly, the CTC for Kusile was estimated at around R80 billion in 2007, rocketing to R225 billion by 2016.

Organisations can use one system or a combination of them. Once this has been identified, the organisation must develop specific risk management strategies.

14.4.2 Step 2: Develop risk management strategies

Strategic risk management has become a very important focus for organisations, and in 2013 already 81% of large companies indicated that they limit their focus to traditional risk areas such as operational, financial and compliance risk.³¹

Much of the focus of **corporate governance** frameworks, such as the King IV Report, is on the role and duty of governance structures to manage strategic risks. For this reason, strategic risk management is generally regarded as a CEO and board priority.

Figure 14.8 Types of business risks³²

Strategic risks destroy the greatest value
Share price impact and audit time allocation across risk categories
n = 61.

Likelihood of occurrence

Percentage of risk failure leading to a significant market decline*

Executive time spent

Percentage of time spend by audit departments on risk types



Source: CEB 2014 Share Shocks Analysis

*A significant market decline is defined as a drop in market capitalisation of more than 40% in a single year.

From the figure, it can be seen that the corporate audit department spend the least time (6%) on strategic business risk assessment, while much more time (42% and 39% respectively) on operational and financial reporting risks. However, when considering the impact on the business, 86% of business failures are due to strategic risks, with only 9% and 2% respectively attributed to operational and financial reporting risks.

The Case example of Netcare that follows illustrates how they have gone about setting risk management strategies.

CASE EXAMPLE: Risk management in Netcare³³

Netcare Limited is the largest private hospital network in South Africa and the United Kingdom. Their risk management framework shows how they identify, understand and mitigate risks. Their strategic objectives are aligned with the risks identified. Although not all risks can be fully mitigated as it is not entirely within the control of the organisation, Netcare Limited SA has developed specific risk management strategies to reduce the potential risks identified. A summary of their top five risks identified and some examples of their proposed risk management strategies are indicated in the table below.

Risks	Risk management strategies
Consistent quality of patient care	Implementation of electronic patient records to improve patient safety and care

Risks	Risk management strategies
Funding of increased healthcare costs	Participation in efficiency discount options and designated service provider networks which offer members lower contributions
Declining economic growth forecast	Expanding into high-growth service lines
Increased competition	Attracting and retaining specialists in SA through equity arrangements
Changing industry regulations	Include primary care in comprehensive prescribed minimum benefits to increase demand

Several technology developments have an influence on developing risk management strategies. With the advancement of internet technology, an abundance of data, which the organisation can use to determine potential risks and develop risk management strategies, has increasingly become available.

14.4.3 Step 3: Set risk management standards

There are many risk management standards to guide managers in developing a risk management strategy, such as those developed by organisations such as the Project Management Institution, the International Organization for Standardization (ISO), the National Institute of Science and Technology, actuarial societies and the Committee of Sponsoring Organisations of the Treadway Commission (COSO). The two more well-known risk management standards are those developed by the ISO and COSO frameworks. The COSO framework was established in 1992 and updated in 2013, and addresses the risks of intentional or unintentional non-declarations in financial statements.³⁴ It provides the following framework to address issues related to internal control:³⁵

- *Control environment:* This refers to a set of standards, processes and structures for carrying out internal control throughout the organisation.
- *Risk assessment:* This is the process for identifying and assessing risks that may prevent the achievement of objectives. It should consider set risk tolerance levels, and will influence how risks are managed.
- *Control activities:* These are the actions established by means of policies and procedures to ensure that risks are mitigated, either preventatively or reactively.
- *Information and communication:* Internal communication should emphasise the importance of the risk management process, while external communication focuses on the inbound communication of relevant external information and providing information to external parties in response to requirements and expectations (e.g. annual reporting).
- *Monitoring activities:* Ongoing monitoring and evaluation should take place to ascertain whether all five components of the framework are in place and functioning as they should.

However, the most popular risk management standards used by organisations are the ISO 31000 ones as they cater for any organisation regardless of its size, activity or sector.³⁶ Organisations using ISO 31000 risk management standards can compare their risk management strategies with an internationally recognised benchmark, and so provide sound principles for effective risk management and corporate governance. In the Case example below, we look at the ISO standards for developing a risk management strategy.

CASE EXAMPLE: The ISO standards for risk management³⁷

An ISO International Standard represents a global consensus on the state-of-the-art in the subject of that standard. ISO has a global membership of 164 national standards bodies, from large and small, industrialised, developing and in-transition countries. ISO has a portfolio of over 19 200 standards that provide business, government and society with practical tools for all three dimensions of sustainable development: economic, environmental and social. ISO provides guidelines to the risk management process and can help organisations increase the likelihood of achieving objectives, improve the identification of opportunities and threats, and effectively allocate and use resources for risk aversion. However, ISO cannot be used for certification purposes. Organisations using ISO risk management standards can compare their risk management practices with an internationally recognised benchmark, and so provide sound principles for effective management and corporate governance. There is no need to address the entire risk management framework or the risk management process as outlined in ISO. However, because the focus is on the assessment of risks from emergency events, the management of emergency risks is directed towards and in line with the International Standards for risk management. The ISO risk management framework classifies risks in terms of financial, infrastructural, marketplace and reputational risks. Within these categories, strategic, tactical and operational risks should be identified.

The setting of risk management standards to achieve risk management strategies is essential for organisations that strive towards sustainability. Although management has the overall responsibility for managing risks, they should consult their board of directors and stakeholders to evaluate the risk management standards proposed so that they could be most beneficial to the organisation. The aim should be to increase the competitive advantage of the organisation, and instil trust and confidence in stakeholders. Once the standards are approved, the organisation should proceed to develop appropriate policies and action plans on how to achieve the set strategies and standards.

14.4.4 Step 4: Develop risk management policies and action plans

Risk management policies and actions plans must be developed to guide the implementation of risk management in the organisation, and must be approved by top management in a board meeting. To enhance the risk management policies and action plans developed, the organisation must ensure that they are aligned to its objectives. To aid the implementation process, the risk management policies and action plans should be simple, practical and easy to understand. Risk management actions plans necessitate that the organisation allocates the necessary resources for their execution. Committed employees with the right analytical skills can lead to effective implementation of risk management action plans. However, employees also need to have access to the right technology to implement them, and the processes and procedures necessary to implement them must be clearly outlined. They must be communicated to employees so that they can be proactive in identifying potential risks and be aware of how to deal with each one. Transparency and accountability are key to effective risk management.

However, it is pointless if an organisation develops policies and plans, but does not strictly implement them, as illustrated in the case of KPMG below.

CASE EXAMPLE: Code of Conduct³⁸

KPMG clearly stated in its code of conduct that those who manage others must act as ethical role models and act responsibly in a fair and accountable manner guided by their core values and in compliance with laws, regulations and professional standards. It was further indicated in the code that it is KPMG's duty to guard against bribery and corruption. However, KPMG's involvement with the Gupta empire since 2008 was questioned in 2017. The Gupta family has been implicated in several 'state capture' allegations involving state-owned Eskom,

Denel and Transnet, and a dairy project in the Free State. The Independent Regulatory Board for Auditors is in the process of investigating KPMG's involvement in the use of R30 million of taxpayers' money to fund a Gupta wedding in 2013. In addition, there seemed to have been closer ties between the Guptas and some KPMG staff than necessary, as they received invitations to Gupta family events, such as tickets to a 2010 Soccer World Cup match, and attending the New Age and Diwali celebrations. Because of these allegations, KPMG's reputation has seriously suffered with many clients defecting. To their clients it appears as if they do not follow the policies set out in their code of conduct.

As a result of the scandal, the CEO, Trevor Hoole, and country risk management partner, Steven Louw, along with six other senior managers have since resigned. KPMG has also taken disciplinary action against Jacques Wessels, the lead partner in the audits of the non-listed Gupta entities. As part of KPMG's actions plans to improve governance and risk management, they have appointed a full-time head of risk to manage client acceptance and retention. They also plan to annually publish a transparency report about the company's processes and control.

For effective implementation of risk management policies and action plans, management must allocate roles and responsibilities to staff (governance), specifying the acceptable risk level (risk appetite) and the responses to risks (risk mitigation). Risk rules, procedures and how each risk will be dealt with should be specified as far as possible. In other words, when drafting risk management strategies, it should clearly:³⁹

- indicate all anticipated risks and the severity of each one
- distinguish between critical and non-critical risks
- describe the extent of each risk in-depth
- indicate the action required to reduce the likelihood of the risks occurring
- outline the actions necessary to reduce the impact of the risks on the organisation and business environment.

If the existence of an organisation is threatened, this is often because it did not implement its risk management policies and actions plans, as illustrated below with Ford Kuga case.

CASE EXAMPLE: Ford Motor Company's Kuga dilemma⁴⁰

Ford SA was in the news when they had to recall the Kuga 1.6 models after some of these vehicles caught on fire. In December 2015, one person died as a result of a Ford Kuga exploding. In spite of this, Ford did not fully investigate the matter. It came to a head in December 2016 when owners discussed their anger and frustrations about safety concerns on social media. This led to the recall of 4 556 Kuga models with 1.6 engines built between December 2012 and February 2014.

The company was then forced to behave ethically by requesting Kuga owners to take their cars to the nearest dealer in order to get the affected components checked and replaced, and warned them not to open the bonnet of the car in event of the fire, but to leave the vehicle immediately. Because of this incident, with 40 reported cases of engine fires, and the manner in which Ford SA managed the crisis, the company suffered huge damage to its reputation. They acted only after owners used social media to express their concerns, and did not address the issue when an individual died.

This was not Ford's first misstep, as the company had many problems with the design of the Ford Pinto, which remains a controversial case. The fundamental design issues led to deaths in rear-end accidents, but despite being aware of them, the company did not make changes, as this would not have been cost effective. Although not their fault, Ford also had problems with the Firestone tyres on their cars. This led to the recall of 15 million tyres in 2000 owing to a safety-related defect, and the long-time relationship between the two companies was terminated as a result.

There are generally three strategic risk management action plan implementation problems:

- **Risk aversion**
- Different risk functions ending up operating in silos and duplicating work
- Employees as a source of risk.

First, too much focus on the analysis of risk versus reward can result in ‘risk aversion’ (a low-risk appetite), and if risk is avoided at all costs, growth opportunities are missed. In response, the organisation needs to do the following to encourage faster and better strategic decisions:⁴¹

- Encourage a focus on taking and managing risks, rather than on purely avoiding or preventing it. Without taking some risks, innovation and growth are not possible.
- Instead of being addressed as two separate processes, the strategic planning process should be informed by the annual enterprise risk management assessment, and vice versa. In other words, strategic management and strategic risk management should be integrated.
- Establish a shared company-wide risk appetite by developing formal statements of risk appetite that guide day-to-day decision-making. A successful statement will use layman’s terms and real-world examples when talking about risk appetite.

A second problem with the implementation of strategic risk management policies and action plans is that different risk functions end up operating in silos, which leads to the duplication of work. Each operational risk management function in the organisation focuses on addressing very specific risks, with enterprise risk management also operating in its own domain instead of integrating the various risk management functions. To address this problem, organisations can do the following to limit duplication and increase the return on investment of risk management:⁴²

- Ask operational managers only for what is necessary and ask them once. This requires prioritising, sequencing and integrating the information collection process for all risk management functions.
- Use existing datasets and business intelligence systems to better predict where risks could occur in the organisation, rather than buying or creating new systems and surveys.
- Critical thinking skills are required to extract insight from risk information, but are often in short supply, especially among more junior employees. By developing critical thinking skills in areas such as data analytics and root-cause analysis, the ability to identify and respond to risks is enhanced. Encourage greater information flows – particularly self-reporting – from the middle of the company, not just from senior leaders.
- Mid-level managers are an important source of risk information. They often receive direct feedback from employees and customers, and by encouraging them to share information across the organisation, potential risks can be highlighted.

Thirdly, while organisations tend to focus on risk management planning, they often overlook the fact that employees are the biggest source of risk. To reduce the risk associated with human behaviour, organisations can do the following:⁴³

- Risk screening can form part of its recruitment, appointment and HRM processes.
- Risk culture and soft controls like building morale, shared values and openness should feature prominently in the HRM processes and be embedded in the risk management process, audit methodology and compliance programmes. These standards increasingly provide leading indicators of where risk may arise in the corporation.
- Focus on principles that guide employee behaviour rather than just focusing on compliance with rules.
- Focus on high-risk employee populations by providing training that requires application and understanding of how risk concepts apply to their jobs, rather than just creating awareness of risks.

As risk management is an ongoing process, performance should be monitored to effect improvements when necessary.

14.4.5 Step 5: Monitoring and improving risk management performance

There should be ongoing evaluation of risk performance to review risk response strategies. Continuous monitoring is essential as the organisation learns from its experiences. This validates that the risks are correctly identified and assessed, and that the controls in place to manage the risks are effective. It further ensures that the organisation remains relevant when changes occur in the business environment. Quality information is crucial in this stage of the risk management process, as there must be evidence:

- about what has occurred compared to what has been identified as risks
- how the intended risk treatment plans have been utilised, and to what extent they were successful
- regarding assumptions, methods and data sources used and their accuracy
- of what the difference between the projected and real performance results is
- about the reasons why a specific risk management action plan has been selected.

In monitoring which risks occurred and whether the measures adopted led to the intended outcomes, it is necessary to keep a risk register. This is to document details about the reason(s) for deviation from intended strategy, the action implemented to counteract the risks, and how effectively and efficiently the procedures took place. The risk register enables the organisation to make better future risk assessments, and implement better risk management controls. Risk management requires involvement of staff at all levels. Good communication must take place between and among the different hierarchical levels. A discussion of the information contained in the risk register can create a culture of learning from mistakes made, and grow the experience of staff for better risk identification. It also encourages accountability for actions taken without just putting the blame on staff.

Internal communication is important in reviewing risk performance. It is recommended that a risk management champion for managing risks be identified. This champion should attend board and committee meetings, and provide regular feedback on the risk performance. Providing risk training to employees and including risk management objectives in their performance appraisals could ensure improved risk performance and effective pursuing of the objectives of the organisation. Risk management is thus an important aspect of an organisation's governance, management and operations, which leads to sound performance management. The next Case example shows how Ford Motor Company's organisational structure may pose a risk when disregarding the significant conditions within a region or not taking cognisance of the needs of the national markets. This could seriously affect a company's competitiveness and business sustainability.

CASE EXAMPLE: Top-down Approach⁴⁴

Ford Motor Company has three geographic regional divisions that cover all the company's marketing activities globally. Although the norm is to have a geographic division of regions per continent or sub-continent, Ford Motor Company only has three regional divisions worldwide, namely:

- The Americas
- Europe, Middle East and Africa
- Asia Pacific.

The company has a top-down approach where each of these regions is governed by an executive vice-president reporting to the CEO, and middle managers reporting to the executive vice-president. Ford Motor Company also has 11 functional groups representing a specific business function. The benefits of this structure are that there is global direction and control that allows easy integration of business strategies and does not complicate its approach to markets. However, the risk that it poses to this company in terms of this simplification is that it disregards distinct conditions within national markets or addressing specific needs pertaining to these markets. To further illustrate the risk of having this organisational structure, the question can be posed: Can this company

use the same strategies within European and African markets? Just think here, for example, about government stability or the level of economic development in these particular markets.

Ongoing external risk performance reporting is expected by stakeholders to gauge whether the risk performance of the organisation is improving. As risk disclosure is a forward-looking activity, it provides organisations with insight to improve their business sustainability in the rapidly changing business environment. For this reason, those attending board meetings should ask themselves the following questions as part of sound governance:⁴⁵

- Can we trust the risk performance data presented?
- Are all risks reported on?
- Is the information about risk performance up to date?
- Is the risk performance data presented in an easily understood manner?
- Are possible actions for improving risk performance provided for discussion?

To assist the board in understanding the progress made, **risk appetite metrics** should be set. These metrics should include both financial (expressed in percentage) and non-financial metrics, which can be expressed in any measure. The metric can either indicate the minimum acceptable requirements to be met or the maximum amount of loss to be tolerated. Examples of a risk appetite measure are shown in [Table 14.1](#).

Table 14.1 Financial and non-financial risk appetite metrics⁴⁶

Financial risk appetite metrics	Non-financial risk appetite metrics
• Earnings • Cost of equity capital • Liquidity ratio • Return on investments • Market share loss • Expenditure for damaged goods • Credit costs • Cash flow ratio • Share growth	• Number of failed business transactions • Number of cyber attacks • Number of main suppliers for key materials • Demand to production rate • Number of alternative suppliers • Size of unused floor space • Number of lost customers • Days out of stock • Number of customer complaints • Number of excess materials in stock • Network downtime in days • Employee turnover rate • Number/cost of litigation actions • Negative social media reviews

The importance of measuring business risk performance should not be underestimated as it assists towards business sustainability. When there is high business environmental stability, most risks can be addressed via a formal strategic risk control system. When there is low business environmental stability, a flexible strategic risk control system is desirable.

Managing risks is thus a dynamic process. It is essential that an organisation identifies and assesses risks in the light of its intended objectives. The continuity of any organisation depends on risk and performance management. Organisations should develop a framework that unifies performance, risk and compliance management.

REFLECTION BOX:

In this chapter we have seen that corporate audit departments devote just 6% of their time to strategic risks, yet these risks destroy 86% of market value (see [Figure 14.8](#)). Why do you think corporate audit departments do

not spend more time on understanding and dealing with strategic risks?

14.5 Summary

The question is thus why risk management is so important for organisations today. Maybe the answer lies in considering the consequences of failing to do so. To survive in the dynamic changing business environment, the challenge for organisations is thus not only to formulate strategies, but also to ensure they can manage risks that could prevent them from achieving their strategic objectives. For organisations to thrive in the competitive business environment, awareness of the risks that can derail their strategic performance is essential. In this chapter, it was indicated that strategic risk management requires the identification of risks as well as the assessment of them, and prioritising them in terms of impact, likelihood and frequency of occurrence and vulnerability of the organisation to the risks. How to go about developing risk management strategies and policies, and action plans to combat risks occurring were also addressed. The benefits of applying risk management practices are that it:

- assists management to make sound decisions
- aids in more effective resource planning
- minimises the impact of a financial or non-financial loss when the risk occurs
- contributes to the effective development of strategies towards business continuity.

For that reason, continuous focus on the use of risk management practices, assessing them and improving on them is essential and can contribute significantly to the success of the organisation.

Opening case study questions

1. Why is strategic risk management important for any organisation, and in particular for SAA?
2. How could SAA have avoided the recurring risks? Provide examples from the Opening case study to support your discussion.
3. Which risk management control systems are essential for SAA to monitor its risk management performance as mentioned in the case study?

Discussion questions

1. Discuss the importance that strategic risk management plays in being a sustainable business.
2. Explain the steps in engaging in a strategic risk management process.
3. Explain how to go about identifying potential risks that may affect the organisation.
4. Explain the four risk management treatment strategies that organisations can choose from, and give a practical example of each.
5. Discuss the requirements necessary to implement effective risk management policies and plans.
6. Discuss the two types of risk management control systems that can assist organisations in effectively managing risks to achieve intended objectives.
7. Indicate the measures to put in place to improve risk performance in an organisation.
8. Explain the benefits of effective strategic risk management for organisations.

Using knowledge and skills

1. Interview a senior manager at your company of choice to determine the following:

- a) Their risk management policies and plans
 - b) The types of strategic risk control they utilise and how they have utilised them
 - c) How they are managing their risk performance
2. Identify a company that has incorporated risk management into their strategy planning. Interview a senior manager in that company to determine the role the board of directors and senior management play in reviewing their risk management policies and plans.
 3. Choose two companies in South Africa and acquire their risk management reports from the internet. Compare the extent to which you think they are managing their risks based on their risk management performance.

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Suggested websites

- IRMSA Risk Report. 2017. 3rd ed. https://www.irmsa.org.za/page/2017_Risk_Report – Read more about South Africa's top risks and how global risks impact South African businesses.
- South African Reserve Bank. <https://www.resbank.co.za/AboutUs/RiskManagement/Pages/default.aspx> – Read the various articles showing the complexity of risk management, taking into consideration the unique role and functions of the bank by considering national interest considerations when applying risk management practices in line with statutory and constitutional responsibilities in an ever-changing business environment.
- Subramaniam, A. *Risk management framework: Process, tools and techniques to minimize risk exposure*. <https://www.slideshare.net/anandsubramaniam/risk-management-framework> – A slide show on the types of risks, categorising them and risk response management
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- Risk management and internal control system. <http://annualreport2014.volkswagenag.com/group-management-report/report-on-risks-and-opportunities/risk-management-and-control-system.html> – An example of how Volkswagen structured their risk management model
- Expert Model. <http://www.expertsystem.com/strong-risk-management-framework/> – Read about some benefits of risk management for organisations.
- Allianz Risk Barometer. https://www.agcs.allianz.com/assets/PDFs/Reports/Allianz_Risk_Barometer_2018_EN.pdf – Read the report on the current risks important for South Africa.
- The Committee of Sponsoring Organisations of the Treadway Commission (COSO). <https://www.coso.org/Pages/default.aspx> – Read more about COSO.

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CASE STUDIES





PART 1 CASE STUDY

Sean McCoy

Exxaro Powering new possibilities

Late in 2005 Kumba Resources engaged in an unbundling and corporate restructuring exercise separating the coal and other assets from its iron ore business.

While iron ore became a stand-alone entity, the primary coal business was merged with several other businesses to form a new company. A marketing task team was assembled to consider the brand for what was initially a project defined as 'Newco'. This would reflect the largest BEE transaction in corporate South Africa. It would also reflect the largest black-owned and -managed mining corporation at the time, through the merge of Kumba Resources coal assets, Ticor, Eyesizwe Coal, and ultimately Namakwa Sands.

Legal and governance processes were demanding around this transaction, and it would take a year to successfully launch the Newco project as a business on the JSE.

In November 2006, Exxaro was born as an exciting new mining and resources entrant in an evolving industry sector in the country.

During its first decade of business as Exxaro, the company made several interesting acquisitions, formed joint ventures, and explored new African markets in pursuit of further growth and expansion.

There were both successes and challenges as the company continued to enhance its minerals and resources portfolio. This included a significant investment in Tronox, an international producer of titanium dioxide and alkali chemicals; a development venture into the Republic of Congo, additional iron ore investments and an interesting play in the cleaner energy space, and creating a joint venture company, Cennergi, together with Tata Power.

Although not CEO at the time, Mxolisi Mgojo was a dynamic member of the executive team and the head of coal during the formative Exxaro years. He always spoke of a future for the company that would represent a broader spectrum of resources interests. In April 2016, a decade later, Mgojo took over the reins of the organisation as CEO from industry veteran Sipho Nkosi.

During this transition period, the business portfolio was consolidated, and the focus repositioned as a coal-mining business, with investments in iron ore, pigment manufacturing, renewable energy (wind) and residual base metals. It did not, however, take long for him to begin the process of organisational renewal. Toward the end of 2017, in conjunction with a newer and younger executive team, an evolving business strategy was unfolded and gradually shared within the organisation and to the market during 2018.

The organisation is now further shifting its strategy, building on its strength as a coal-mining company and moving toward a newly defined 'business of tomorrow', seeking to address the challenges facing the fossil fuel industry. This shift embraces alternative energy, water and agribusiness, which is a considerable change from the current coal business. It does, however, do so off the success and importance of its coal business. driving the 'business of tomorrow' from a sound platform of the business of today. This change necessitated bold leadership and an ability to take some 10 000 people across business units and the corporate centre on the journey toward a new, purpose-led future.

The business of today

Coal remains a central part of the Exxaro strategy and continues to attract considerable investment in terms of new developments, technologies and processes. It is the foundation on which the business has been built over the years, and it will very much fuel the future strategy of the organisation.

Furthermore, it is the country's second largest earner after gold, providing 6.1% of total merchandise exports. South Africa holds the sixth-largest coal reserves in the world, representing approximately 11% of the world's total coal reserves. Exxaro's coal operations can be found in Mpumalanga and Limpopo where the country's highest concentrations are found. This allows the company to support South Africa's growth through a steady supply of this essential mineral while seeking to make the sector more competitive on the international stage, guided by constant improvements in people, processes and equipment.

The importance of this strategic asset base to the company is highlighted by looking at some of what it defines as mega projects within the business. The new Belfast mine project as an example represents a R3,3 billion project to produce thermal coal in the Mpumalanga region, with the first production expected in 2020 and the first-phase construction representing a 17-year life of the mine. Another of its operations, Grooteegeluk in the Limpopo province is among the most efficient mining operations in the world, operating the world's largest coal producing complex from a single pit with mineable reserves of more than 30 years.

Coal mining is also challenged by the advent of technological change, however, and artificial intelligence and machine learning all have an impact on the world of work. Exxaro has placed great emphasis on embracing this bold new world and the impact of disruptive technologies on driving organisational excellence throughout the existing business. This effects the business unit operations as well as the functional centre and its respective disciplines. Organisational excellence now lies at the heart of the business strategy and is seen holistically across the business. This drives new ways of working; a new corporate office that supports this concept; increased digitalisation across all dimensions of the organisation, including automation, bots, data analytics, etc. Very critically, this leads to an evolving organisational culture that is preparing people for change.

The business of tomorrow

While the business of today in the form of coal and the related resources investments are driving the current performance of the organisation, Exxaro leadership has recognised the immense challenge facing fossil fuels in the future. It further recognises the critical role that a mining organisation could and should play in uplifting people, specifically the communities in which it operates. This new imperative is driven by a purpose-led business strategy that is directed at improving lives across the African continent. Beyond the latest business buzzword 'sustainability', the company and its leadership are intent on delivering a sustainable and better future for the organisation, its critical stakeholders and ultimately the planet at large.

While the business of today focuses on mining and resources, it leverages the business of tomorrow into sustainable territories around alternative energy, water and agribusiness. Although there are some parallels with the world of mining, this is a fundamental departure from its primary business, and this necessitates talent and skills changes, structural business changes and a significant shift in mindset and organisational culture. In a direct extract from the Exxaro strategy:

We want to be part of Africa's success and future. This means we need to take a forward-looking approach to our business. Our future goal: To exist as a thriving business.

We want to make an impact on the world, Africa and the communities where we operate, which is why in all our sectors, we exist to solve societal needs and become a 'Champion of Africa'. We exist to create a better life for all our stakeholders.

To position ourselves in an ever-changing world, we looked at the things that drive our basic human needs and the businesses that exist around them.

As a result, we directed our vision to the following areas – Coal, Renewable Energy, Water and Agri.¹

The business of tomorrow, as it is referred to, has been created as a different business unit with a significantly different operating model. It is expected to be light on capital, more entrepreneurial and agile, fast-growing functions with high returns and rapid development. Consequently, it requires a very different management team, governance structures and modus operandi. It relies on strong partnerships with leading organisations in their

respective fields, which has a different operating model to the long-term, capital intensive requirements of mining.

In basic terms, the business of tomorrow is described as follows:

- **Renewable energy:** it will explore new ways to create, maintain and store energy, focusing on distributed small energy generation, energy analytics, energy exchange and energy funding
- **Water:** it will discover ways to save and generate this precious resource through leak management technologies, waste management solutions, treatment plants and creating water from new sources such as desalination
- **Agri:** it will focus on the greater farming value chain and supportive technologies to ensure food security through sustainable agriculture, including farm-to-market logistics, food processing and aquaculture, as well as new food sources such as insect protein and biofuels from feedstock.

This signifies a considerable shift in the future business of Exxaro, but one which is anchored in a sustainable future and a purpose-led strategy for the organisation. The emphasis extends beyond quarter-by-quarter financial results, and rather represents a bold new vision in an evolving world of work. Realising this strategy is a work in progress and is currently driven under the umbrella of an organisation-wide initiative known as Connect2Next. This initiative aims to amplify and orientate the company toward the future, embracing aspects such as the overall strategy, the required culture, operational excellence, business excellence, the workplace strategy and the digital focus at Exxaro.

While these bold changes are firmly under way, and the organisation prepares to relocate to the new corporate office in June 2019. Operational investment and project progress are on track, and the company has just celebrated an exemplary set of results as posted for its financial year ending December 2018. This included excellent gains in all the key financial metrics, bolstered by record production, sales and export volumes of coal.

Against the backdrop of the leading ESG (environmental, social and governance) performance in the local industry, the CEO has reiterated that Exxaro is purpose driven for a long-term future, with the coal business remaining core, while driving at the risks and opportunities arising from climate change.

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Case questions

1. Exxaro has faced some challenges from the investor relations community on the new strategic direction of the business. How do you think the company overcomes the challenge of being perceived as a mining-only organisation?
2. The new business direction requires a significant culture and behavioural shift among managers and employees. How best does Exxaro take all staff on this new strategic path?
3. Do you think that Exxaro can stretch from mining across such a diverse business portfolio? What are the pitfalls it may face and the key ingredients for success?
4. Discuss the requirements of a purpose-led organisation. What does it take to distinguish this from a business fad to a sustainably successful company?



PART 2 CASE STUDY

Peet Venter

Absa's planned resurgence: Turbulence ahead for the South African retail banking industry?

Background

The fight for dominance of South Africa's retail-banking segment hots up. Absa, once the nation's biggest consumer lender is considering a change in tactics to boost revenue and to regain its former leadership in the retail-banking industry. In March 2018, the Group CEO Maria Ramos, announced the bank's intention to restore its leadership in South African retail banking and to double its share of revenue in Africa from 6% to 12%. She also said the Group would begin to build a culture of entrepreneurialism and consistent delivery to customers.¹ However, regaining its position as market leader will not be easy, and the bank is facing a number of challenges.

Overview of the South African banking industry

Despite South Africa's status as a developing economy, it has a sophisticated and stable banking system, comparable to those of most developed countries. This, along with the advanced risk management practices applied by South African banks, meant that, unlike in many other countries, no banking crisis occurred in South Africa after the 2008 global financial crisis.²

Despite this stability, banks have faced a tough few years, and things are starting to shake up as the South African Reserve Bank (SARB) has issued its first banking licences for new entrants in 11 years. In 2017, there were 19 registered South African banks, and a number of other national and international players in the industry. However, as reported by the SARB (see [Exhibit 1](#)), this number has been very stable over the last decade, and the last time a new banking licence was issued was when Capitec entered the industry in 2001.

Although there has been some stability in the sector, the average cost to income ratio of banks has risen steadily, while return on equity has been declining at a similar pace. This suggests a relative increase in the average cost base of banks (see [Exhibit 2](#)) most likely due to the challenging conditions currently facing South African banks.

The banking sector is particularly vulnerable to low economic growth, and the slump in South Africa's GDP has resulted in banking revenues growing at their slowest rate since the global financial crisis. Plummeting oil and commodity prices in 2014 and 2015 have sent various commodity-dependent sectors into turmoil, from which they have been slow to recover. As a result of poor economic conditions, lending fell across the board, while earnings remained stagnant. Another result of these tough conditions is that advances grew at a higher rate than deposits, prompting banks to raise interest rates in order to ensure revenues.³

Exhibit 1:⁴

Table 1.1 Banking entities registered in South Africa

2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
------	------	------	------	------	------	------	------	------	------	------

Registered banks and local branchesBanks*	19	19	18	17	17	17	17	17	17	17	19
.....											
Of which: banks under curatorship	0	0	0	0	0	0	0	1	1	0	0
.....											
Local branches of foreign banks	14	14	13	13	12	14	14	14	15	15	15
.....											
	33	33	31	30	29	31	31	31	32	32	34
Other Controlling companies	16	16	16	16	16	16	16	16	16	16	18
Banks in final liquidation ...	2	2	2	2	2	2	2	2	2	2	2
Mutual banks	2	2	2	2	2	3	3	3	3	3	3
.....											
Cooperative banks	0	0	0	0	2	2	2	2	2	2	3
.....											
Representative offices	46	43	42	41	43	41	43	40	40	36	31

*Includes active banks and banks exempted by the Registrar of Banks (with effect from 1 July 1006) in terms of the Supervision of Financial Institutions Rationalisation Act 32 of 1996 and section 1(cc) of the Banks Act 94 1990

Exhibit 2⁵

Table 1.2 Selected indicators for the South African banking sector

	Dec 2016	Dec 2017
Balance sheet		
Total assets (R billions)	4 877	5 157
Total assets: year-on-year growth (per cent)	0.96	5.75
Gross loans and advances (R billions)	3 708	3 802
Gross loans and advances: year-on-year growth (per cent)	2.98	2.54
Total equity (R billions)	401	455
Profitability		

Cost to income (smoothed) (per cent)	55.07	56.65
Return on equity (smoothed) (per cent)	17.69	15.96
Return on assets (smoothed) (per cent)	1.32	1.31
Capital adequacy		
Common equity tier 1 capital adequacy ratio (per cent)	12.43	12.88
Tier 1 capital adequacy ratio (per cent)	12.86	13.43
Total capital adequacy ratio (per cent)	15.93	16.22
Leverage ratio (per cent)	6.20	6.62
Liquidity		
Liquidity coverage ratio (per cent)	107.83	119.02
Credit risk		
Impaired advances (R billions)	106	108
Impaired advances as a percentage of gross loans and advances (per cent)	2.86	2.84
Specific credit impairments as a percentage of impaired advances (per cent) ...	43.88	42.57
Portfolio credit impairments as a percentage of gross loans and advances	0.70	0.74

Things are not looking up as the financial sector is facing global challenges of digital disruption and other threatening regulatory restrictions aiming to counter the rise in cyber-attacks. Just as banks were starting to get to grips with the Financial Intelligence Centre Act 38 of 2001 (FICA)⁶ and the National Consumer Protection Act⁷, they had to consider the impact of General Data Protection Regulation (GDPR) and the Protection of Personal Information (POPI) Act on their operations and systems⁸. In addition, banks are preparing for the implementation of the Basel IV package, which is focused on ‘reducing the variability of risk-weighted assets and enhancing the credibility of the risk-based regulatory capital framework for banks’ by 2022⁹.

Note: This table presents an overview of the financial and risk information, compiled by means of the aggregation of data submitted during 2016 and 2017 from individual South African-registered banks (including domestic branches of international banks but excluding offshore branches and subsidiaries of South African banks, mutual banks and cooperative banks). Information represents aggregated bank-solo information. Smoothed refers to calculations based on a 12-month moving average. Information is subject to change without notice. Banking sector data is available at <http://www.resbank.co.za> (refer to Prudential Authority link).

The South African Reserve Bank

The SARB is the overseer of the banking industry, ensuring that banks adhere to their strict licensing requirements. Despite its central role in monetary policy, the SARB is not owned by the government but privately owned by about 650 shareholders. The functions of the SARB include, inter alia¹⁰:

- Formulating and implementing South African monetary policy
- Managing the money supply, for example by issuing banknotes and coin
- Supervising the South African banking system
- Ensuring the effective functioning of the national payment system (NPS)
- Managing the country's official gold and foreign-exchange reserves
- Acting as banker to the government
- Administering the country's foreign exchange and
- Acting as lender of last resort in exceptional circumstances.

Recently, calls from within the ruling party to nationalise the SARB have resulted in a national debate, with some commentators claiming that the marginal loss of transparency (due to the loss of private shareholding) could increase the long-term risk of more aggressive or more politically sensitive policy interventions¹¹.

The ABSA turnaround

Absa is one of four large banking groups in South Africa, the others being Standard Bank, FirstRand and Nedbank. The 'big four', as they are often referred to, are characterised by their full and integrated service offerings, diversification into non-lending revenue sources (such as insurance), ubiquitous points of presence in the form of ATMs and branches, and complex group structures. Collectively, these four banks control about 88% of South Africa's banking assets, and the African operations of these banks (outside of South Africa) contribute a significant proportion of their revenue¹². [Exhibit 3](#) contains a summary of each group, while [Exhibit 4](#) compares the banks on a few selected key performance indicators.

Exhibit 3: The 'big four' South African banks¹³

Absa Group Limited is listed on the JSE and is one of Africa's largest diversified financial services groups with a presence in 12 countries across the continent and around 42 000 employees. The bank was owned by Barclays (a UK-based banking group) until recently, when Barclays reduced its shareholding in Absa to about 15%.

FirstRand was founded in the 1970s as an entrepreneurial investment bank. Differentiated by its owner-manager culture, FirstRand executes its strategy through a portfolio of leading financial services businesses comprising of First National Bank (retail banking services), Rand Merchant Bank (corporate banking solutions), WesBank (asset financing), Ashburton Investments (investment management) and Aldermore Bank plc (UK). FirstRand is known for its entrepreneurial orientation (e.g. it spawned and then spun off several successful businesses such as Discovery and OUTsurance), its innovativeness (especially with regard to technology), and its very successful e-Bucks rewards programme.

Nedbank Group's primary market is South Africa, but their expansion into Africa is ongoing. Nedbank has a presence in six countries in the Southern African Development Community (SADC) and East Africa region where it owns subsidiaries and banks in Namibia, Eswathini, Malawi, Mozambique, Lesotho and Zimbabwe, as well as representative offices in Angola and Kenya. In West and Central Africa, the bank acquired approximately 20% shareholding in Ecobank Transnational Incorporated (ETI) in 2014, enabling a unique one-bank experience to clients across the largest banking network in Africa, comprising more than 2 000 branches in 39 countries. Nedbank overcame a major setback in 2004 when it received support from its parent company, Old Mutual plc, and launched a recovery programme to restore the performance of the group and to retain its position as one of the 'big four'.

Standard Bank Group offers a range of banking and related financial services across sub-Saharan Africa. The group's strategy is to be an African-focused, client-centred, digitally enabled integrated financial services organisation. Standard Bank has a 156-year history in South Africa, and the group started building a franchise in sub-Saharan Africa almost 30 years ago. Currently the group has an on-the-ground presence in 20 countries on the African continent, and solid local knowledge required to operate a successful business in Africa.

Exhibit 4: A comparison of the ‘big four’ on selected indicators¹⁴

	Absa	Firststrand	Standard Bank	Nedbank
Assets (R billion)	R1 171	R1 447	R2, 1 (trillion)	R1044
Headline earnings (R billion)	R8	R26.5	R27.9	R13.5
Return on ordinary shareholders’ equity (5-year average 2014–2018)	16.6%	23.9%	15.4%	15.5%
Number of ATMs	10 019	4 866	9 321	4022
Employees	41 250	46 284	31 662	30 877
Country presence	12 in Africa	9 in Africa	20 in Africa	39 in Africa through Ecobank alliance

Standard Bank is the largest of the ‘big four’ in terms of assets and headline earnings at this time, while FNB consistently has the highest return on equity. Competition among the ‘big four’ is generally fierce, and banks are constantly looking for ways to cut costs, for example by closing branches, reducing headcounts and encouraging customers to use digital channels. Absa’s planned resurgence as a market leader would require a lot of change, as Absa seems to be lagging not only in financial terms, but also in customer satisfaction, rated lower than its peers at 73% (compared, for example, to FNB at 81%). In March 2018, the Group CEO, Maria Ramos, announced the bank’s intention to restore its leadership in South African retail banking and to double its share of revenue in Africa from 6% to 12%, with a strong focus on creating a culture of entrepreneurialism and consistent delivery to customers. Absa plans on driving growth in loans, which had stagnated, and deposits, where margins came under pressure recently. According to Cowyk Fox, managing executive of Everyday Banking at Absa’s Retail and Business Bank, ‘[t]here’s capacity for lending in the right spaces in the market but it depends on where the economy goes. A lot of customers are good for credit, but they are sitting tight waiting to see where the economy goes¹⁵’. One thing was for certain, Absa’s efforts to improve its position were not likely to go unchallenged¹⁶. To complicate things even more, competition for Absa was not limited to its peers, as niche banks and new digital entrants were also eyeing a slice of the considerable pie.

Niche banks

The remaining South African banks (excluding the ‘big four’) are generally niche banks that focus on one or just a few market segments with a limited product range. Banks that compete in this segment are generally small compared to the large banks (see [Exhibit 5](#)). Capitec is by far the best performer in this segment, boasting the highest return on equity of all South African banks and the most customers – an estimated 9.9 million by February 2018, more than any other South African bank. Capitec claims that, on average, 100 000 new customers join its ranks every month¹⁷. The bank uses technology innovatively to target the lower end of the market with simplicity, affordability, accessibility and personal service, with a limited yet innovative product range. This essentially consists of savings plans and unsecured credit, but offers a single point of access to transacting, saving and credit.

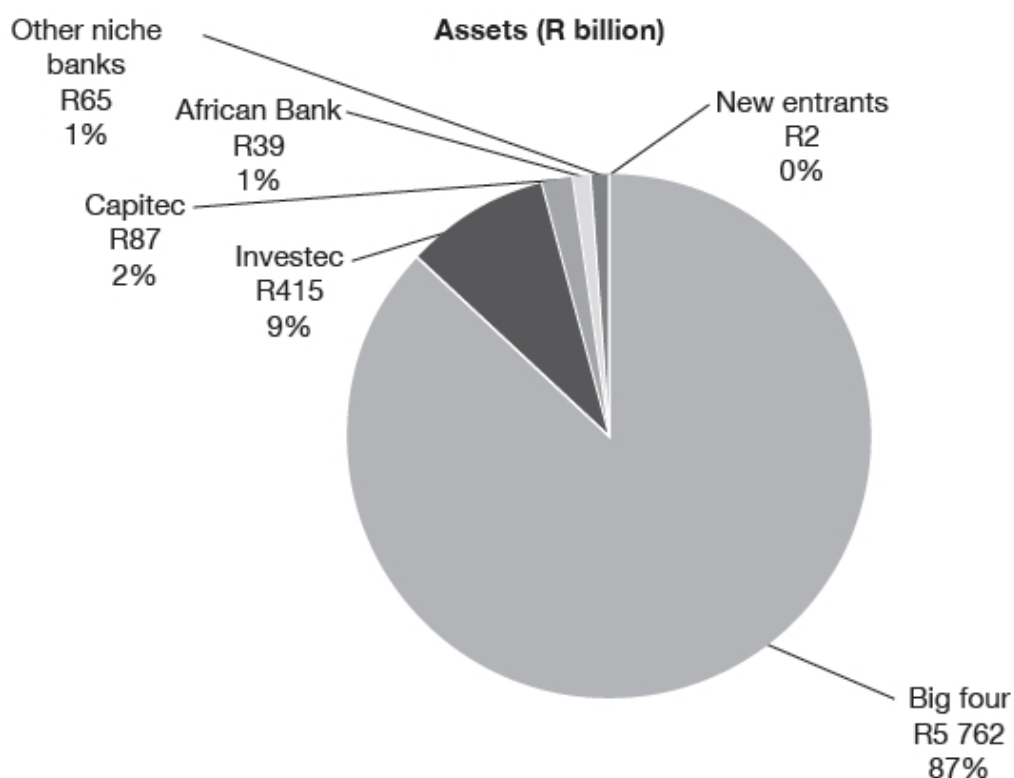
A brief summary of other banks in this sector are provided below:

- Sasfin Bank, Mercantile Bank and Investec are focused on the higher end of the market. Both Sasfin and Mercantile are specialist banking groups, focusing on entrepreneurial private, commercial and corporate

clients. Investec focuses on high-net-worth individuals and businesses who are less price sensitive and more focused on service quality, even if at a premium.

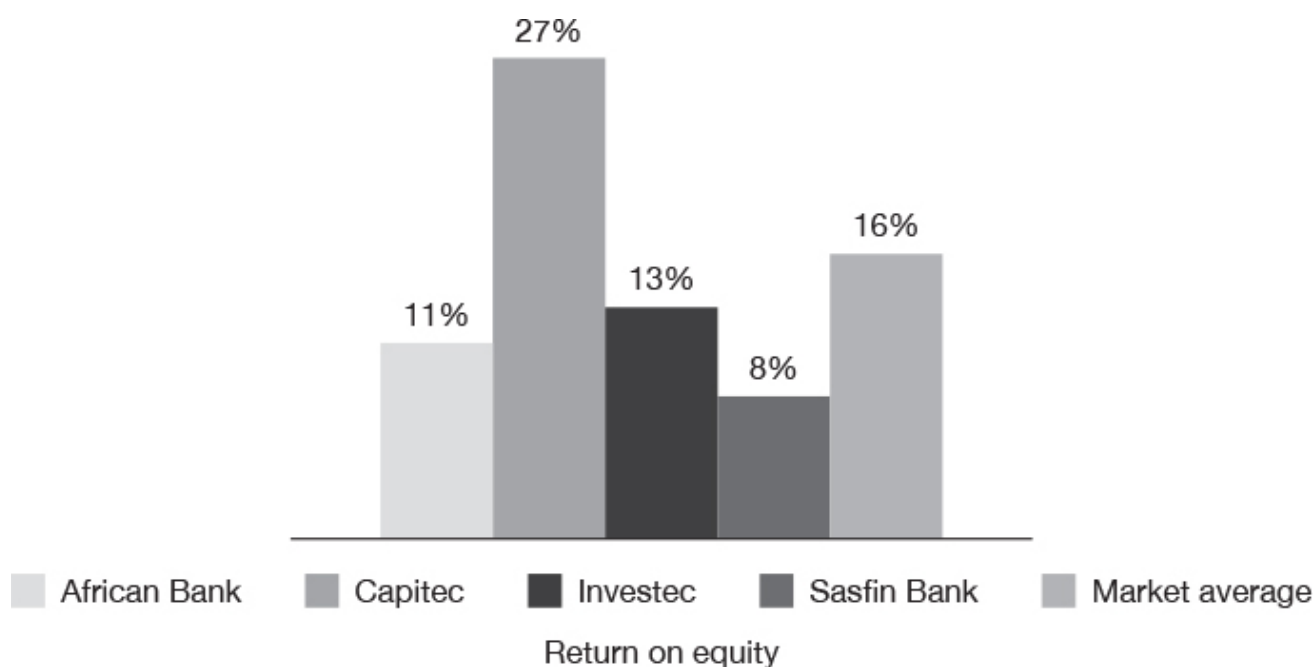
- African Bank targets a similar market to Capitec, but is only now re-emerging after a period in curatorship following its near-collapse in 2014, while Ubank also targets lower income consumers (aiming to become the 'workers' bank of choice'), with a strong basis in the gold and platinum mining communities.
- Grindrod Bank (an investment bank) and Bidvest Bank (offering personal and business banking) are smaller-scale banks established by corporate groups.
- Albaraka Bank differentiates itself on the basis of faith, offering Islamic banking to Muslims worldwide.
- There are also some local operations of international banks, namely the Bank of Athens and Habib Bank Zurich (or Habib Overseas Bank).

Exhibit 5: Comparative assets of South African banks¹⁸



On the basis of financial performance, Capitec is a top performer in the South African banking industry with a consistent return on equity of 27%. However, other banks in this category have struggled to perform on par with the industry, unlike the 'big four' banks that consistently outperform their global counterparts on the basis of ROE.

Exhibit 6: The ROE of listed niche banks 2018¹⁹



The new entrants

In 2018, the SARB issued the first three new banking licences in 11 years to Bank Zero, Discovery Bank and TymeBank, three new South African digital banks. These 'digital newcomers' were betting on using aggressive pricing and data analytics to attract tech-savvy, price-conscious consumers. In addition, the South African Post Office's Postbank has applied for a banking licence, which will allow it to offer a wider range of services. This was the first time since the entrance of Capitec in 2001 that the sector faced new competitors. They all expect to have substantially lower cost-to-income ratios than the big banks, giving them scope to disrupt the pricing of retail banking products in South Africa. 'I have been dumbfounded at how low the cost can be,' said Bank Zero's co-founder Michael Jordaan, best known for turning FirstRand's retail banking operation into the most profitable in South Africa. 'Our technology cost is 1 per cent of 1 per cent of the annual tech budget at one of the big banks'²⁰. In addition, the new players are also likely to put pressure on other traditional banking tactics in the form of interest on credit and savings.

Discovery Bank plans to build its banking business on the same principles as its Vitality loyalty programme that helped Discovery's health insurance business become a market leader. Vitality is a behaviour-tracking programme that rewards health insurance clients for healthy lifestyles, such as by paying for gym memberships, and Discovery plans to use the same principles to target the group's two million health insurance clients, rewarding them for achieving financial health²¹.

TymeBank has teamed up with retailer PicknPay to offer a money transfer service for the retailer's Smart Shopper programme clients, giving TymeBank a large pool of potential customers to target with its digital services. It also means that PicknPay's more than 700 branches become de facto points of presence for the bank.

TymeBank is also believed to be seeking partnerships with retirement funds firm Alexander Forbes and insurance giant Sanlam. Partners like these could offer TymeBank further access to potential customers and data²².

Bank Zero is aiming to use technology to drive down its costs and offer banking services at much lower rates than incumbents, especially in business banking. CEO Michael Jordaan said that their goal is to challenge banking fees. Jordaan added that their aim is to tackle high business fees especially related to the extremely high fees that businesses have to pay for card transactions and electronic banking fees²³.

The new entrants will initially focus on South Africa, but may consider other emerging markets in due course and, given their strong ICT platforms and digital nature they may find it easier to expand globally. However, in

South Africa banking services have a high rate of market penetration (> 80%) and the challenge to the newcomers is going to be breaking into a very competitive market where customers are traditionally reluctant to switch banks.

Fintechs

While financial technology businesses (fintechs) were originally perceived to be a big threat to incumbent banks, they are generally thriving by forming partnerships with incumbents in the banking and insurance industries rather than by competing head-on with them. Fintechs generally focus on providing solutions to customer or banking 'pain points' (such as fraud and KYC – 'know your customer') that banks struggle to address. Combining the innovative thinking and technology of fintechs with the large, established customer bases, distribution networks and capital investment of incumbents produces a powerful customer value proposition.²⁴ Fintechs can also help to service market segments that are traditionally difficult or unappealing for banks to service, such as the SME sector. For example, Nisa Finance, InvoiceWorx and Merchant Capital (partnering with Standard Bank) offer innovative finance offerings for SMEs, who often struggle to get financing from the big banks. Growing confidence in new technologies such as artificial intelligence (AI) will drive a spate of new applications for the industry, such as chatbots, which ease the process of customer interaction with financial services companies, and automated wealth advisors. These applications can contribute to banks and insurers offering more innovative services and better customer service.

The future for ABSA?

While there is some anxiety in banking boardrooms about the new entrants in the banking industry, Absa seems relatively unconcerned. Cowyk Fox said that they are able to easily compete with digital banks. He went on to say that despite the better prices offer, the cost base of a legacy bank can be one of a few advantages that they have over the digital competitors.²⁵ Absa aims to retain its retail clients by offering better prices to loyal clients, responding faster to their needs and proactively managing their accounts. The new strategy will allow Absa to take on more risk after London-based Barclays cut its former controlling interest down to below 15%. Absa executives were generally upbeat about the Barclays withdrawal, suggesting that decision making could now return to executives on the ground, and that they will face less bureaucracy in general.

Absa seems confident that, going forward, the new strategy will be shielded from new competitors, which will, in their view, be capital light and more transactional in nature. In contrast, Absa's drive to increase their assets like home loans will (according to them) provide a strong basis to offer more transactional banking.

Conclusion

While incumbent banks may not relish new competition, consumers are likely to benefit through more innovative offerings, more competitive pricing and higher interest rates on savings accounts. The question is: who will be the winners and who will lose in the new banking landscape?

Questions

1. What are the key opportunities and threats facing South African banks?
2. Would you regard the South African banking industry as an attractive industry to invest in?
3. Would you regard fintechs as competitors or complementors in the industry?
4. Conduct a strategic group analysis of the South African banking industry. Clearly identify the mobility barriers between strategic groups.
5. Use a resource-based perspective to explain the success of Capitec Bank.

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PART 3 CASE STUDY

Francois du Toit

Ethiopian Airlines – A national asset

‘Ethiopian Airlines is our national pride and a special icon among our companies as it carries our common name Ethiopia and our national flag,’ said Prime Minister Dr Abiy Ahmed during the inauguration of a state-of-the-art passenger terminal and the Skylight Hotel.¹ The Skylight Hotel at the Bole International Airport in Addis Ababa is something of which to be proud. With 373 guest rooms and spacious executive suites, the largest Chinese restaurant in Africa and a conference hall that can accommodate 2 500 people, it is state of the art, as is the new passenger terminal, which features the latest technology security systems, self-check-in machines, a self-boarding system, comfortable lounges, duty-free shops and other amenities. These facilities, however, are just another manifestation of the success story that is Ethiopian Airlines, fondly referred to as just ‘Ethiopian,’ the pride of Ethiopia.

The results from Ethiopian Airlines are impressive, with operating revenue of US\$3,7 billion in 2017/18,² and a net profit of US\$233 million. Growth has been similarly impressive with a 43% rise in operating revenue amounting to US\$3,7 billion in 2017/18, and an average growth of 25% a year since 2010. It expects to carry 10,6 million passengers during 2018, up from 3.7 million eight years before. Ethiopian Airlines is the biggest African airline by passenger volume, by revenue and by profits.³ In fact, it has been the only profitable African airline since 2013.⁴ It is no wonder, then, that industry observers suggest that ‘[i]f you want to fly on the continent’s best airline, with the world’s most modern aircraft, then it has to be Ethiopian. During traumas from famine to revolution, the airline has managed to deliver those two elusive qualities: customer service and profit.’⁵

Strategic direction

Ethiopian Airlines is an unexpected success story on a continent where state-owned entities notoriously poorly run. It is 100% owned by the Ethiopian government. Ethiopia only changed to a democracy from a Marxist military regime in 1991, and is as yet is not a fully market-driven economy. The new prime minister, Dr Abiy Ahmed, who came into power on 2 April 2018, is driving economic and political reforms. In a major policy shift in June 2018, the government also relinquished its monopoly on several key economic sectors, including aviation and telecommunications, and said it would allow for ‘outright full privatization’ in certain sectors such as railway, sugar and hospitality.⁶ The pace of economic and political change has increased significantly, and the new cabinet that Dr Abiy put together, reduced by a third to 20 members, has no less than 50% female members. ‘Our women ministers will disprove the old adage that women can’t lead ... This decision is the first in the history of Ethiopia and probably in Africa,’ Dr Abiy said.⁷ Dr Abiy followed this by appointing the country’s first female supreme court president,⁸ and then the boldest move of all – the appointment of Birtukan Mideksa as head of the electoral board, who is not only a woman, but also the founder and leader of the opposition UDJ party. He made this appointment just after her return from exile in the US after granting her amnesty from her life sentence. She was convicted of an attempt to overthrow the government in violent demonstrations in which dozens of people died after the 2005 elections.⁹ The government’s policies resonate throughout the airline. In 2019, it celebrated International Women’s Day with an all-female-operated flight to the Norwegian capital, Oslo. The entire flight management team comprised of women: the pilots and cabin crew, the in-flight ramp operators

as well as flight dispatchers on the ground. This is not the first time the airline has operated such a flight. In March 2018, a similar flight between Addis Ababa and the Argentine capital, Buenos Aires, was undertaken. In December 2017, Ethiopian Airlines made history by sending one such team on an intra-Africa trip from Addis Ababa to Lagos, and before that, in late 2015, a similar crew flew passengers from Addis Ababa to the Thai capital, Bangkok.¹⁰ Ethiopian Airlines has also committed to running a 'green airline', signing a memorandum of understanding (MoU) with the United Nations Environment, outlining several action areas to promote sustainability, most notably the development of the 'Plant one tree for every passenger flown' project. The objective of the project is to plant nine million trees in the name of Ethiopian Airlines in different regions of Ethiopia. Other areas of collaboration include greening the airline business through providing training on sustainable consumption and production, integrated waste management, hazardous chemical treatment and capacity development on air-quality monitoring.

The UN in turn will support the Ethiopian Aviation Academy with the introduction of a course on the UN Programme Environment Sustainable Consumption and Green Economy Programme.¹¹ All these changes bode well for a state-owned commercial carrier competing in the international market.

So how does an African state-owned airline manage to compete successfully in the global travel market, as Calder¹² and deliver customer service and profit? As is frequently the case, the success or failure of many corporations can be ascribed to parenting style. To have government act as a parent might seem to be the answer on the surface but it has directly led to the demise of many a carrier. On the upside, government has the power to ensure a trading environment, which affords the airline its own incontestable competitive advantages in the local market. Unfortunately, to government, commercial success is often secondary to other political objectives. State-owned entities primarily exist to render service to citizens, even if such service is at the expense of profits. Secondly, state-owned entities are renowned for inefficiencies. This is probably the result of the submissive position of profit in the parent's imperatives, or the enshrined local market dominance, or the lack of skills of political appointees, or a combination of all of these. In Africa, state-owned airlines are often vehicles for government corruption (see the widely publicised case of South African Airways). The Ethiopian government has successfully refrained from meddling in the management of Ethiopian Airlines.

However, not to have government intervention does not automatically guarantee aviation success. Ethiopian Airlines is additionally reaping the synergies from its parent's ability to (combined with the political desire to) make Ethiopia competitive in the region and world economy. Dr Abiy's government has taken the Ethiopian economy to number one in Africa with growth of 8.5% in 2018.¹³ Government has focussed on infrastructure investment, and Ethiopian Airlines has benefited with the new Bole Airport, the biggest in Africa. Ethiopian Airlines has benefited by making online applications possible due to modernised government systems to bring it into the internet era .

The Ethiopian government,, the sole stakeholder in Ethiopian Airlines has minimal intervention. This should mean apathy and disinterest. Ethiopian Airlines is a major contributor to, and critical enabler of, the Ethiopian government's aspirations to move to a market-driven economy. The CEO of Ethiopian Airlines, Tewolde GebreMariam, said that Ethiopian Airlines already makes a significant economic contribution to the nation while being efficient, competitive internationally and able to raise capital for growth. In light thereof, privatisation plans are more likely to see foreign involvement in various operating units than an outright sale by government of its stake.¹⁴ Ethiopian Airlines create strategic objectives for in conjunction with the Ethiopian government and these objectives are aligned with government's policy directions. For example, the 15-year strategy it launched in 2010 to win back market share on routes to and from Africa, as well as the latest strategic roadmap, Vision 2025, that will see Ethiopian Airlines continuing the introduction of new systems and technologies and playing an indispensable role in the socio-economic development of Ethiopia and Africa at large.¹⁵

Strategies and tactics

The performance and aspirations of Ethiopian Airlines warrants further exploration of its specific competitive strategies and tactics. The first step was to regain the share of the international passengers it once commanded. The intercontinental strategy is two-pronged – the first being a focus on increasing the number of transcontinental destinations, in addition to increasing the frequency of flights. An example of the increased

frequency is its services from Bole Airport to Heathrow with three extra round trips each week to its Addis Ababa hub. It has also secured some degree of flexibility, at least on Saturdays, Sundays and Wednesdays. On those days, the inbound morning plane will resume the return flight three hours later, and land in Addis Ababa on the same day.¹⁶

Growing its share of travel to the US, Ethiopian Airlines introduced three-times-a-week flights to JFK International Airport in New York, in addition to the flights to the city's Newark International Airport. This was done towards 'restructuring the network, opening new destinations, adding frequencies and shifting gateways as it seeks to offer passengers travelling between Africa and the US the best possible connectivity and the shortest routes'. Ethiopian Airlines also substituted Los Angeles for Houston as a destination to take advantage of the large African community in the city, its concentration of oil companies and others that conduct business on the continent. This route will be served three times a week via West Africa. Ethiopian Airlines also increased its Washington DC flights from daily flights to 10 flights a week, with the additional three flights departing from Addis Ababa in the morning and arriving in Washington DC via Abidjan in the evening. Subsequently these three flights per week were increased to five, and a new route to Chicago was established, its fifth destination in the US. US Secretary of State, Rex Tillerson, commented during his visit to the country that 'Ethiopia is becoming a critical hub for intercontinental traffic for people traveling from the US, [which] is going to promote a great deal of interest in Africa and in Ethiopia.'¹⁷ CEO of Ethiopian Airlines, Tewolde GebreMariam justified the expansion strategy as the US being among the airline's most important markets due to the presence of a large African community, and growing business and tourism ties with Africa. 'In line with our roadmap, we will keep on expanding our US and African network to facilitate people-to-people ties and the flow of investment, trade and tourism. Our new route structure with additional frequencies to multiple gateways and the opening of new routes to Houston are in response to the market demand and will provide the best possible connectivity to over 60 African destinations,' said Tewolde.¹⁸ Outside of the US and Europe, Ethiopian Airlines is launching new routes from Addis Ababa to Jakarta and Geneva,¹⁹ as well as a new route to Shenzhen, China – the fifth city it serves there.²⁰

The second prong of its growth strategy is alluded to when mentioning increasing the number of African destinations to 'over 60', serviced from the hub in Addis Ababa, but also as direct destinations in their own right from intercontinental flights as stopovers to the Bole, Addis Ababa hub. From newly introduced daily flights to New York, four will be via Lomé in Togo to Newark Airport, and three via Abidjan in Ivory Coast to JFK.²¹ The increased number of African destinations additionally expands its potential intercontinental customer base – critical for its prosperity, as in 2015 Africa accounted for only 3% of air passenger traffic. The airline looks to make the Ethiopian capital a transport hub, connecting other African countries, without long-haul capacity, with continents around the world. 'It's trying to feed traffic from other African countries through Addis to then give them the connectivity to travel on to other continents, US, Europe and Asia in particular.'²²

As for positioning for the future, air traffic within the African continent is forecast to grow 6% a year, twice as quickly as mature markets and faster than any other region over the next two decades.²³ The state-owned carrier does not just want to dominate the continent's skies but is also looking to boost Africa's fragmented airspace through increased connectivity, setting up visa hubs that would allow more tourists to travel across Africa, as well as launching or reviving new sovereign African airlines.²⁴ 'The task of African integration is not easy,' Tewolde said in an interview. 'The context is the need for air transport. There is huge demand. We are responding to it.'²⁵

In 2010, Ethiopian Airlines announced its 15-year expansion strategy. First, it assisted with the launch of Togo's ASKY Airlines in West Africa, followed by the acquisition of a 49% share in the Malawian flag carrier in southern Africa in 2013.²⁶ In addition, Ethiopian Airlines is involved in business ventures with Air Côte d'Ivoire and Congo Airways, and has taken over management of CEIBA International in Equatorial Guinea. The Zambian government has announced that it is working with Ethiopian Airlines to relaunch its national carrier, with Ethiopian Airlines owning 45% of the shares. Plans have also been unveiled to establish a wholly owned airline in Mozambique, as well as the signing of a contract to start an airline in Guinea. Ethiopian Airlines has also taken stakes in a Chadian airline. Tewolde said the new airline in Chad would draw in passengers from

Cameroon, Central African Republic, Niger, northern Nigeria and Sudan.²⁷ It announced that it is in discussions to back the Nigerian government's plans for a new national carrier, as well as plans for the company to buy a 20% stake in Eritrea Airlines as part of a new peace deal, starting with flights between the neighbouring states.²⁸

Ethiopian Airlines was forced to adopt a piecemeal approach to expansion because full African air transport liberalisation has failed to materialise, despite several attempts. In 1999, 44 African countries signed the Yamoussoukro Decision in Ivory Coast's capital, giving airlines freedom to ferry passengers between two foreign countries. This agreement, however, has barely started as governments moved to protect domestic carriers. To try to revive the stalled process, 23 African governments signed another deal in 2018 to forge a single aviation market,²⁹ the so-called Single African Air Transport Market (SAATM), an initiative by the African Union that aims to open up Africa's skies. 'Twenty per cent of the market is carried by African airlines and 80% of the market is carried by non-African airlines,' said Tewolde. 'The market share [held by African airlines] has been declining for the last 20 years.' Ethiopian Airlines is positioned to profit from it. The expansion is part of the airline's 2025 Vision to become the leading aviation group in Africa, and increase the share of the market occupied by African airlines.³⁰ Within the next 30 years, Addis Ababa is expected to double the number of travel consumers and hit US\$2.5 billion.³¹

In its pursuit of growth, Ethiopian Airlines has now expanded its African freight operations to the US. Already the largest cargo operator in Africa, serving more than 92 international destinations across five continents, it has won the SKYTRAX World Airline Award for Best Airline in Africa, 'African Cargo Airline of the Year' and 'Air Cargo Brand of the Year in Africa' awards four years in a row.³² Global expansion of its freight business was always the next logical step. On 29 August 2018, Ethiopian Airlines launched weekly freighter flights between Addis Ababa and Miami, creating the first-ever cargo-only route between the African continent and Miami International Airport. The route includes stops in Spain, Colombia and Belgium. With the new service, Ethiopian will carry Inditex high-end textile products from Zaragoza to the Americas. 'In line with our strategic roadmap, Vision 2025, we will keep on expanding our cargo destinations worldwide, thereby facilitating trade and economic growth among different regions of the world,' Tewolde tweeted.³³

Ethiopian Airlines is collaborating with the European Union to establish a graduate business programme, hosted under the airline's Aviation Academy, a six-decade-old training centre that currently provides instruction in pilot and cabin-crew training, maintenance services, and leadership courses.³⁴ The MBA programme epitomises Ethiopian's Pan-African strategy, while for the EU, establishing a graduate school in Ethiopia signifies the growing interest to establish more world-class business programmes on the continent.

Growth strategies are capital intensive. They require expenditure on acquiring additional aircraft, expanding facilities to handle increased passenger traffic, increased cargo traffic and training facilities. The new aircraft Ethiopian Airlines purchases are what its whole business revolves around, as it provides for increased capacity; optimises efficiencies, which supports profitability;³⁵ and affords its customers a state-of-the-art travel experience. These aircraft represent the image and customer offering of Ethiopian Airlines: 'They have one of the newest fleets in the world ... SE and Boeing Co aircraft. For the first time in the history, an African airline can compete with the Middle East and European airlines in intercontinental skies.'³⁶ It was also the first African operator to take delivery of the Boeing 787-9 Dreamliner, to be deployed on its US passenger routes.³⁷ The freight routes will utilise B777-200LRF freighter aircraft. On 1 March 2019, the first B737-800 freighter was delivered, the first of its kind in the Ethiopian cargo fleet. Regarding the new aircraft, Tewolde said: 'The B-737-800 freighter will give us a new capability to serve short-haul destinations in African and the Middle East more economically, which includes the export of Ethiopian meat, fruits and vegetables to the Gulf Region.'

Developed with the industry's most efficient and reliable technology, the new B737-800 freighter aircraft is the newest member of the freighter family and offers greater efficiency for the standard-body freighter market. It has a carrying capacity of more than 23 metric tonnes of payload with excellent operating economics to maximise efficiency for cargo operations.³⁸ Plans include a repeat order for the Boeing 787, probably the 787-9 variant, which would double the size of the existing fleet.³⁹ Western banks are assisting in financing plans to boost its fleet of 108 planes, with 66 more on order. Chinese banks are involved too, partly reflecting Beijing's drive to

build a new trade corridor to the Middle East and Africa.⁴⁰ Chinese banks have been especially prominent in financing Bole Airport upgrade investments.⁴¹

Some observers have been concerned about the risks involved in Ethiopian's strategies, not that the carrier has been anything but cautious. Tewolde declared: 'The carrier is also looking at the Airbus A350-1000 and seeking to evaluate whether the model would perform sufficiently well out of Addis Ababa, which combines a hot climate with an altitude of close to 8 000 feet, making it a testing location for aircraft. It already operates the smaller A350-900 plane.'⁴² It has also cut back on some initiatives and realigned its strategies. For example, the airline has cancelled its Los Angeles destination,⁴³ and shelved plans to establish a fleet of smaller jetliners as gains in demand suggest that the routes where they would be deployed would be better served using larger planes. Some of these decisions were made in anticipation of exceeding forecast demand: 'We have decided to suspend the evaluation of the 100-seater regional aircraft acquisition project, since the market size of the selected regional routes is growing faster than we expected. Boeing 737 jets from the current fleet will instead be used while the airline studies passenger trends,' Tewolde said.⁴⁴

The risks highlighted are in the main related to those inherent to new business ventures. In most cases so far, Ethiopian Airlines has taken minority stakes in 'start-up' airlines and tried to implant its management culture into the target organisations, often in nations haunted by costly failures of state carriers. Ethiopian Airlines has been spending tens of millions of dollars in some of Africa's toughest markets, but this could be a risky strategy, as buying minority stakes as a means of expanding into other markets has proven disastrous for others, such as Abu Dhabi's Etihad. Servicing debts is at risk if traffic does not pick up fast enough at its new hubs in Togo, Malawi and Chad. In addition, none of the new destinations are in major centres: Lome is far smaller than west African cities such as Nigeria's economic capital Lagos, or Abidjan in Ivory Coast, while Chad's dusty desert capital is even smaller. 'You want to build [a hub] in a place where you are going to get local traffic and connecting traffic,' said Craig Jenks, president of consultancy Airline/Aircraft Projects Inc. Another threat is that of 'self-competition,' as Zambia's relaunched flag carrier could steal traffic from Ethiopian's existing southern African hub in neighbouring Malawi, Yamlaksira Getachew, a management professor at Loyola Marymount University, warned.⁴⁵

Then, on Sunday 10 March 2019, what Ethiopian Airlines invested in dearly as a competitive advantage and treasured as symbol of its success caused the airline immense reputational damage:

In today's global business headlines:

A Boeing 737 MAX operated by Africa's leading Ethiopian Airline crashed, killing all 157 on board, just six minutes after leaving Addis Ababa on yesterday's scheduled flight to Nairobi. Confirmed among those who died are 32 Kenyans, 18 Canadians, 8 Americans and citizens of France, China and the UK. The aircraft, which was only four months old, had landed just hours before from Johannesburg. This is the second fatal crash of a 737 MAX, the updated version of Boeing's best-selling single aisle plane. In October last year, an identical plane operated by Lion Air crashed into the Java Sea 11 minutes after take-off, killing all 189 people on board. October's accident focused attention on a new stall-prevention system which Boeing designed for the plane. Ethiopian Airlines is the continent's largest, having quadrupled passenger numbers four-fold in the last decade to the current 10m a year. The airline last suffered a fatal crash nine years ago.⁴⁶

Strategy is about assuming risk in return for profits, but how does an organisation mitigate risk when it emanates from such an unlikely source?

Questions

1. What are the sources of Ethiopian's competitive advantage in your view?
2. Critically evaluate Ethiopian's corporate growth strategy.
3. How would you describe Ethiopian's global strategy? What are the risks inherent to this strategy?
4. If you were in the top management team of Ethiopian, how would you handle the air disaster of 10 March 2019? Provide motivations for your answer.

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PART 4 CASE STUDY

Mari Janse van Rensburg

Medine: Masterplanning community development

Since 1911, the Medine Group has a long and proud history as a pioneer in many fields. From humble beginnings, the Group has grown and expanded from being solely a sugar producer to becoming a diversified organisation, operating with a workforce of 1,200 on the island of Mauritius.

Medine Limited, which is listed on the secondary market, Development and Enterprise Market (DEM) of the Stock Exchange of Mauritius (SEM), has just made the decision to move from the DEM to the official market (SEM). It features among the Top 20 Mauritian companies in terms of Market Capitalisation.¹

Being relevant

Located off the southeast coast of Africa, Mauritius is an island state of approximately 1.3 million inhabitants. The country's economy has made great strides since independence in 1968, from being mostly dependant on their agricultural commodity (sugar), to being one of the most successful small developing countries. Continued economic growth and foreign investment followed government programmes to drive privatisation, financial market liberation, and industry development.

Although sugar continues to contribute to the island's export earnings, the economy has expanded to include manufacturing, tourism, technology, education, renewable energy, real estate development, smart cities, and financial services amongst others.

Described as the "pearl of the Indian Ocean", the island's idyllic landscapes, tropical climate and pluralistic culture attracts not only international tourists but also skilled foreign professionals, investors and retirees. These expats enjoy an island lifestyle while they benefit from professional opportunities, a secure investment climate, conducive business development policies, and tax benefits.^{2 3}

The history of the Medine Group is inherently linked to that of Mauritius, and the Group grew along with the Mauritian economy and over time differentiated its activities into four clusters, namely agriculture, leisure, property and education.^{4,5}

Agriculture

The agricultural cluster of the Medine Group, historically linked to sugarcane, now includes several sectors of activity ranging from sugarcane production, plant cultivation, fruits and vegetables, to renewable energy. This cluster plays an essential role in the development and protection of Medine's land. The cluster also includes the Medine nursery and Medine landscaping. Although Medine's landscaping services and nursery are not exclusively for the Group, the team mainly works on internal projects as the Group is engaged in the long-term development of a Smart City. The garden centre serves as logistical support to the internal landscaping team. Since 2019, in a joint venture with Akuo Energy Indian Ocean, Medine offers electrical energy through a photovoltaic farm.

Leisure

Responding to opportunities created by the fast-growing tourism industry, the Leisure Cluster of the Medine Group consists of various businesses, including:

- Casela World of Adventures: The most visited tourist attraction in Mauritius, hosting up to 500,000 visitors per year
- Concorde: the Medine Group acquired the well-established travel agency and destination management company at the end of 2018.
- Tamarina four-star Golf & Spa Boutique hotel
- Tamarina Golf Club: 18-hole, par 72 golf course
- SPARC (Sports Aquatics and Recreation Centre): The largest multi-sports facility on the West Coast of Mauritius which also host a medical and health centre
- Yemen Experience: The largest deer reserve and preserved nature park on the island featuring an array of experiences accessible to the public such as family adventures, business seminars, and eco-touristic exploration
- Catering: Providing food and beverages within Medine-owned restaurants and cafeterias.

Each of the businesses listed contributes towards providing leisure experiences to residents and tourists. These businesses have also contributed to positioning the west coast of Mauritius as an attractive tourism destination.

Property

The property cluster of the Medine Group is responsible for the sound and sustainable development of the group's land assets. Medine has pioneered a key number of projects including Tamarina Golf Estate, and is mainly focusing its efforts on the execution of Unicity, Medine's smart city, as per the Masterplan published in 2005 for the valorisation of the Group's 10,000 hectares land bank. Within a few years, Unicity has quickly expanded with the launch of a university campus, schools, student residences, office parks, shopping centre, and other building projects.

Education

Through Unicity Education Hub, Clusterthe Medine Group provides, through high quality education. Using exclusive partnerships with leading international institutions, it covers an educational offering which ranges from nursery level to executive education, with higher education as its main pillar. Higher education spearheads the vision towards the setting up of a knowledge-hub through an integrated and international campus.

See far, look closely

The current organisational structure follows an ambitious strategy to position the Group as a pioneer in sustainable and harmonious development. The foundation and implementation of the strategy was spelt out in 2005 in the Medine Master Plan (MMP) by M. Pierre Doger de Speville, Chairman of the Group in 2005:

Medine endeavours to: 'See far, look closely.'

'See far' to remain faithful to the tradition of the visionaries who founded and developed Medine. 'Look close' in order to equip our various sectors of activity with the modern methods and procedures necessary to fulfil our Mission, which is to build a better future for all.⁶

The MMP details the vision and plans of Medine Limited for the Western part of Mauritius over a twenty-year period. This document, which is in essence a blue-print for the Group's operations, is regularly updated and reviewed to reflect the opportunities and constraints faced by the company during implementation. One of the biggest realisations of the MMP, is Unicity which started its development in 2011. Unicity is designed to combine the key components of a quality city life, to ensure overall economic, social and environmental sustainability through achieving a delicate balance between residential, business, commercial, educational, healthcare, sports and recreational uses.⁷ Medine was one of the first companies to apply for, and meet the criteria of the Smart City Scheme (SCS) introduced by the Mauritian Government. The SCS promotes the development of self-sufficient cities offering integrated working, living and leisure space focusing on innovation, sustainability,

efficiency and quality of life.⁸ In the case of Unicity, the development promotes the concept of “Live, Work, Enjoy & Learn” with education and higher education at the core of its development. It is this concept that creates synergy and strategic alignment between the four business clusters.

Unicity Concept			
Live	Learn	Work	Enjoy
• Residential • Student residences • Retirement village • Healthcare • Third-party developers	• Unicity Education Hub • Nursery and Pre-primary School • Primary School • Secondary School • Higher Education • Executive Education	• Unicity Office Park	• Student Life • Sports • Restaurants • Shopping • Green park and art station • Leisure park • Events and nightlife

Trouble in paradise

Medine has achieved a series of developments which have today become landmarks of the West. However, the Group’s financial performance over the years had been poor with a number of businesses generating substandard returns. This culminated in a headline loss of MUR845 million (R341 million, at time of writing) for the 2017/18 financial year.⁹

Time to reflect...

Reflecting on the Group’s 2017/18 performance, Thierry Sauzier (CEO) commented that the performance was disappointing but not unexpected. It was important to put the results into context:

“They reflect challenges which were not new and now had to be dealt with. Sugar, our oldest cluster, has been in constant decline for a number of years, and our Milling operations had been unviable and running at losses for quite some time. When I took over as CEO of the Group last year [2017], it was very clear that a number of courageous decisions had to be taken. I had to acknowledge the reality of the situation: building a healthier and stronger platform for the Group’s future was critical if we wanted to grow sustainable.”¹⁰

MUR845 million is a significant loss but this included asset write offs of MUR595 million (R240,3 million). The remaining underlying losses of MUR 249 million (R100,5million) were below expectation but it reflected a drop in the sugar price, timing with regards to investments and delays in real estate projects completion.¹¹

The way forward

The groups’ overall financial performance was well below par, but the new leadership team implemented by the CEO is confident that they have a clearer picture of the way forward. The 2017/18 financial year has indeed been a year of transition for the Group. Following a reassessment of priorities and short-term objectives the focus will now be on:^{12 13}

- Restructuring of business clusters – Investments will be focused on core areas with established competitive advantage. Such investment will enhance core value propositions and ensure optimal usage of innovation. Specifically:
- The Unicity Education Hub will remain the driving force of the Group’s real estate project as growing student numbers will populate Unicity. As such, the Group will continue to offer and enhance a unique lifestyle for students, offering accommodation facilities, restaurants, a sport centre as well as shopping and leisure facilities. Such facilities will further create an unmatched environment for new institutions to join Unicity
- The property cluster has always generated strong returns and the Group will rely on this cluster to continue generating cash flow and drive overall performance through the development of infrastructure and real estate

that generate recurring revenues

- The acquisition of Concorde, one of the Top 5 local travel agencies and the number 1 Destination Management Company (DMC) in Reunion Island, completes, and strategically consolidates the Group's positioning of its leisure cluster. Offerings within this cluster will benefit from continuous improvement through service delivery and innovation
- The agricultural cluster will be restructured to reduce the financial burden resulting from declines in global sugar prices. The closure of a sugar mill and resulting asset write offs will be followed by further actions to improve the efficiency of operations. The Group will also work with the Government and other stakeholders to find sustainable solutions to the national sugar challenge. Investments will also be made to extend the current production of electrical energy on the 30,000m² roofing in Uniciti
- Shifts in the organisational culture towards a performance-based one with clear accountability within the organisation. Essentially, a new 'Medine model' will be introduced to remove a sense of complacency and take decisive action to face business challenges. Additional key talents have been recruited to enhance the current leadership team and to navigate the Group through a period of change and transformation
- Enhancing corporate parenting advantage through a restructured corporate function that will explore avenues for improving the overall efficiency of operations. This includes the introduction of simplified standards and centralised processes, getting a grip on costs and embracing digitalization and technology.

The leadership team is confident that they are geared to implement the remaining objectives set in the MMP:

'These are trying times, and a mill closure is a particularly strong symbol of how things change in life, and why we must continually adapt in order to progress...'

(René Leclézio, Medine Chairperson)¹⁴

It may be trying times but the Group's CEO is confident that further to the deep restructuration of Medine's financial assets and the operational activities during the past 18 months, the Group is now in position to further benefit from and contribute to the growth of the Mauritian economy. Change is nothing new as this company has a successful record of navigating change since its foundation. But, it will be the efforts, resilience, drive and enthusiasm of staff that will be the key to continuous improvement and growth.¹⁵

Case questions and solutions

1. The Medine Master Plan (MMP) spans over 20 years during which the Group was required to implement various strategies to meet the criteria to develop a smart city. Explain how diverse business clusters contribute towards achieving the long-term vision of the company.
2. Does the CEO display characteristics of strategic leadership? Motive your answer with relevant examples from the case?
3. There is a strong correlation between strategic business performance and risk management. Identify, assess, and classify at least one strategic risk that Medine had to face in the past two years. Comment on their response and the impact it had on the Group's performance.

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Glossary

Ambidexterity theory of leadership – a leadership theory that predicts that different types of leadership are needed for innovative and exploratory behaviours versus implementation-based exploitation behaviours.

Applied design thinking – an approach that applies the methods and mindsets behind excellent design in fields like engineering, industrial design and architecture to the design of business models.

Assumption risk control (also referred to as **premise control**) – the process of gathering data and analysing it systematically and continuously to determine whether the assumptions on which the strategy is based are still valid in the light of new information.

Balanced scorecard – a strategic management tool useful for guiding, controlling and challenging an organisation towards realising a shared conception of the future.

Benchmarking – a tool for identifying an organisation's relative strengths and weaknesses compared to its performance in the past, its competitors or best-in-class performers.

Big data – the very large and complex data sets in large organisations that require advanced and unique data storage, management and analysis.

Blue ocean strategy – creating uncontested market spaces where competitors are made irrelevant because new markets are created.

Bottom of the pyramid innovation – relates to targeting the (typically very large and untapped) segment of poorer customers in a society, particularly in developing countries (termed thus because it is the largest segment and it comprises the lowest earners in a society).

Business intelligence systems (BIS) – internal information systems that provide structured information on the organisation's historical performance.

Business level strategy (also referred to as **competitive strategies**) – strategies that relate to how the organisation will meet its customers' needs, how to counter the competitive efforts of its rivals, how to cope with the existing market conditions, and how to sustain or build its competitive advantage.

Business model – a plan of how an organisation creates value for its customers while simultaneously generating sufficient revenue or surpluses to have above average returns.

Business model – a rationale for how an organisation can create, capture and deliver value.

Capabilities – the organisation's capacity to combine resources into productive activities. Also refers to the various deliverables that the organisation provides to stakeholders.

Collectivism – emphasises collective goals and group harmony as opposed to individual goals.

Competitive advantage – a condition achieved by an organisation when superior value is created for its customers compared with its competitors or when it outperforms its competitors in key areas, such as profitability.

Competitive intelligence (CI) – the process of collecting information about competitors or the marketplace to develop the strategic plans of an organisation.

Complexity theory – a science of complex interacting systems characterised by non-linearity, unpredictability and aperiodicity.

Context-based strategy making – the process of diligently embedding social-ecological context into an organisation's strategy, including the four steps of acknowledging, prioritising, setting strategic goals and tracking progress.

Core competencies – the unique abilities of an organisation that cannot easily be copied by others.

Corporate governance – the exercise of effective and ethical leadership to achieve an ethical culture, good performance, effective control and legitimacy of an organisation (a corporate).

Corporate level strategies – strategies that deal with the overall scale and scope of the organisation.

Cost leadership – a strategy that allows an organisation to achieve superior profits by producing its products or services at a significantly lower cost than that of competitors.

Cost leadership strategy (also referred to as **low cost provider strategy**) – a strategy that is based on low input costs aimed at a price-sensitive market.

Country-specific advantages (CSS) – benefits that could result from lower tax rates, lower financing costs and more inexpensive labour than in the organisation's home country

Creative destruction – the destruction of markets and the failure of certain businesses, as resources are reallocated to more innovative businesses that provide more societal value.

Culture – the outcome of human behaviour based on pervasive and shared norms, values, attitudes and beliefs that people use to interpret experience and generate social behaviour that guides their lives as individuals or as members of a group.

Data analytics – the process of turning big data into useful information.

Differentiation strategy (also referred to as the **premium strategy**) – a strategy that is based on unique and valued offerings in a price-insensitive market.

Disruptive innovation – new ways of doing things (innovation) that can create a new market and value network, which disrupts, or displaces, an existing market and value network.

Distinctive capabilities – unique, valuable capabilities that provide a basis for competitive advantage.

Dominant design theory – a theory that predicts that new technologies can result in a pattern of intense competition between different formats of a product whereby a design will ultimately win out, and the industry will then start to mass produce the 'winning' design.

Dynamic capabilities – the organisation's ability to integrate, build, and reconfigure internal and external competences to address rapidly changing environments.

Economic rent – the ability of resources to attract income.

Economic risk – the likelihood that events, including economic mismanagement, will cause drastic changes in a country's business environment that adversely affect the profit and other objectives of a particular business organisation.

Economic systems – these include market economies, command economies and mixed economies.

Emotional intelligence (also known as **EI** or **EQ**) – the ability to identify and manage one's own emotions and understand and influence those of others – essentially one's ability to work intelligently with one's emotions.

Environmental scanning or strategic surveillance – the monitoring process of the business environment and organisational resources to identify threats or opportunities for the continual existence of the organisation.

External environment – an environment that comprises the macro-environment and the industry environment, and includes all influences outside the organisation that affect a firm's decision-making and performance.

Firm-specific advantage (FSA) – a superior domestic competitive advantage at the outset that a firm needs to have when considering expanding internationally.

Focused strategy – a strategy that is followed by organisations that direct their competitive efforts to a specific niche.

Foreign direct investment (FDI) – involves direct investments in a foreign country for productive business purposes.

Foreign market entry modes – these include exporting, licensing, strategic alliances (which include short- to longer-term contractual agreements), joint ventures, franchising and wholly-owned subsidiaries in one or more foreign countries (an equity-based mode of entry)

Foreign portfolio investment (FPI) – refers to investments in negotiable financial instruments – shares, stocks, bonds, options and futures – in off-shore financial markets.

Functional strategy – strategy specific to each function within an organisation.

Fuzzy front end of product development – relates to the unstructured, dynamic and uncertain first stage of the innovation process where one needs to come up with opportunities and concepts before they can form the basis of the formal development process.

Geopolitical forces and events – continuing conflict that causes pervasive and widespread global and regional disruptions that seriously affect political, business and sociocultural relations, and significantly increase the risk of doing business with countries in affected regions.

Global business environment – a pervasive environment characterised by declining barriers to trade and investment, cultural convergence, improved communications, global networking and improved transportation technologies.

Global companies – MNCs characterised by extensive global networks of operations (global companies are also referred to as **transnational** or **globally integrated companies**).

Global strategy – a strategy involving global standardisation to increase profitability through cost reductions from experience curve economies derived from decreasing costs over time as experience is gained and from location economies; derived from operations in low-cost foreign locations.

Globalisation – broadly defined as the shift away from distinctive national markets towards a more integrated and interdependent world economy.

Globalisation of markets – the merging of traditionally separate national markets into one huge global marketplace over time as a result of converging national value systems, consumer needs and preferences on a worldwide scale.

Globalisation of production – the declining barriers to trade and investment in recent decades, which benefits international organisations.

Gross domestic product (GDP) – a measure of the value of goods and services produced in an economy during a specified period.

Gross national income – measures the total income received by the residents of a country.

Individualism – emphasises the importance of guaranteeing individual freedom and self-expression in pursuance of individual goals.

Industry – a group of organisations offering products or services that are close substitutes for each other.

Integrated reporting – the process of communicating material information about an organisation's strategy, governance, performance, and prospects in a way that reflects the commercial, social and ecological context within which it operates (definition adapted from the International Integrated Reporting Council).

Internal environment – constitutes everything inside the organisation, in particular its resources, capabilities and competencies that enhance its performance.

International business – comprises international trade and foreign direct investment (FDI).

International competitive advantage – organisations that have a distinctive domestic competitive advantage and possess a valuable set of resources that can be leveraged into new markets can consider by either exploiting or enhancing their existing domestic competitive advantage.

International enterprise – could be involved in any international business activity such as importing from and exporting to other countries.

International management – the process of applying management concepts and techniques in a multinational environment and adapting management practices to different political, legal, economic and cultural contexts.

International strategy – a strategy to increase profitability by transferring core competencies to foreign markets where indigenous competitors lack them.

International trade – occurs when a firm exports goods or services to consumers in another country.

Issues priority matrix – an approach that simultaneously assesses the extent of both the probability of a macro-environmental event occurring and extent of its probable impact on an organisation.

KSAs – the requisite expertise and knowhow necessary to run an organisation efficiently and effectively.

Leaders – those individuals who use their skills and ability to influence others to support the achievement of a common goal.

Leadership – essentially concerns the constructive 'influencing' of people to support the achievement of a common goal.

Legal systems – the legal system of a country is influenced by the prevailing political ideology and political system since the government defines a country's legal framework within which organisations conduct business. The three prominent systems in use around the world are common law, civil law or code law, and theocratic law – are defined as follows

Liability of foreignness – this typically results from unfamiliarity due to lack of local country knowledge and information (including political/legal requirements, economic and cultural issues, and infrastructure); additional and often unanticipated costs of managing a foreign operation (including expatriate travel and locating costs as well as subsistence costs for the duration of the expatriate's foreign assignment), and reluctance of locals to do business with the MNE); and discrimination, which is the typical practice of consumers favouring local firms over foreigners.

Long wave theory – a theory of innovation that predicts that there are certain patterns in innovative change and that these can be described as waves, being of longer duration than business cycles.

Low-cost focus strategy – a strategy that focuses on low costs in a narrow buyer segment aimed at outcompeting competitors based on lower costs.

Macro political risk analysis – reviews all major political decisions likely to affect all enterprises in the country

Macro-environment – an environment that includes political, legal, economic, sociocultural, technological, demographic and natural environmental forces at the global level and/or within a country.

Macro-environmental analysis (also referred to as **environmental scanning**) – a systematic process of collecting and analysing information for the purposes of planning, forecasting or choosing a preferred future.

Micro political risk analysis – directed towards government policies and actions that influence selected sectors of the economy or specific foreign businesses within an industry or industries in the country, for example restrictive regulations of a country's telecommunications industry, and restrictive labour laws in selected industries such as mining and exploration.

Milestone review – a control measure to monitor the effective execution of a strategy at various intervals, based mostly on time or cost.

Mission statement – a statement that stipulates the nature of the business and the customers it seeks to serve and satisfy.

Multidomestic or localisation strategy – a strategy to increase profitability by customising products and services to comply with the tastes and preferences of customers in distinct foreign markets.

Multinational enterprise (MNE) – involves ownership and control of productive cross-border business operations through foreign direct investment (multinational enterprises are also referred to as multinational corporations, multinational companies or MNCs).

Multiple connections – the interconnectedness between markets and the constant intensifying diversifying of economic exchanges worldwide.

National competitive advantage – this originates from the internal strengths of successful domestic organisations that innovate and continually improve their processes and refine their strategies within their industries to the extent that their superior product and service offerings become internationally competitive.

Operational risks – losses as a result of inadequate operational procedures, systems or controls, or those caused by employees.

Operational strategy (also referred to as functional strategies) – strategies that deal with how the component parts of an organisation deliver the corporate and business-level strategies over the shorter to medium term.

Organisational architecture – a collectively agreed and communicated document that, in light of the strategic competencies needed to fulfil stakeholder needs, defines and details the major building blocks of the organisation.

Organisational climate – the prevailing atmosphere in the organisation representing how members of the organisation feel about it at a point in time, which can be influenced by particular events.

Organisational culture – a system of norms, values and beliefs that bind the organisation's members together, unifying them in purpose and distinguishing the members of one organisation from another.

Organisational purpose – the fundamental reason and motivation for the organisation's existence. It may be explicit or implicit, and often it is both. It is the single most important, overarching objective of the organisation, which determines the various other, subsidiary objectives that may be identified.

Organisational routines – high-level organisational processes or ways of doing things that create an organisational memory and eliminate the need to reinvent a task every time it has to be performed.

Organisational structure – the pattern of relationships among positions in and among members of the organisation, making possible the application of the process of management and creating a framework of order and command through which activities of the organisation can be planned, organised, directed and controlled.

Paradigm – a world view.

Paradoxical situation – a situation that **has** two opposite facts, or qualities, which one would not expect to be able exist simultaneously.

PESTEL – an environmental-scanning framework that classifies external influences by source, including political, legal, economic, sociocultural, technological, demographic and natural environmental sources.

Political risk – the likelihood that political forces will cause drastic changes in an organisation's business environment that will adversely affect the profit and other objectives of a particular business organisation.

Political system – a system of government in a nation.

Processes – management, operational and support processes that are instrumental in delivering the capabilities.

Red ocean strategy – a strategy of competing in highly contested markets, for example on price, which can be damaging to all involved, as businesses each compete against each other at each other's expense.

Regional economic integration – involves agreements among countries in a geographic region to reduce, and ultimately remove, tariff and non-tariff barriers to the free flow of goods, services and factors among each other.

Regional economic integration (REI) – the growing economic interdependence that results when two or more countries within a geographic region form an alliance aimed at reducing or eliminating barriers to trade and investment.

Resources – the assets, skills and capabilities over which an organisation has control.

Risk appetite – the amount of risk an organisation is prepared to take to meet its strategic objectives.

Risk aversion – a strategy whereby the organisation avoid risk at all costs.

Risk appetite metric – the minimum acceptable requirements to be met or maximum amount of loss that the organisation will tolerate.

Risk profile – the evaluation process of the impact of an organisational threat and willingness to accept the risk.

Risk register – a document detailing the reason(s) for deviation from intended risk strategy, the actions necessary to counteract the risks, and an indication of how effectively and efficiently the procedures that took place were documented.

Scenario analysis and planning – an extremely useful approach in understanding future-orientated macro-environmental, industry and competitive dynamics and change, providing plausible alternative views of how the business environment of an organisation might develop in future.

Shared value – the benefits that an organisation can create simultaneously for itself and its stakeholders.

Social-ecological context – the social and ecological systems, and their inter-relationships, on which an organisation depends.

Social-ecological risks – the risks faced by an organisation due to changes in its social-ecological context.

Special alert risk control – the process whereby the organisation, due to the occurrence of a sudden and unexpected event, thoroughly and rapidly reconsiders the organisation's current strategy.

Stakeholders – any group or individual who can affect or is affected by the achievement of an organisation's objectives.

Strategic alignment – internal driver where various components of an organisation acting together.

Strategic decision enablers – the combination of people, processes and technology that enables the organisation to obtain intelligence about its environment and turn it into useful insights that enable it to make strategic decisions.

Strategic decision-making – deals with decisions that are future oriented and concern the long-term direction on large investments of resources (this entails the whole organisation and is not limited to a specific function or department).

Strategic decisions – future-oriented, fundamental and significant decisions that affect the entire organisation and concern its long-term direction as well as a large investment of resources.

Strategic direction – the overall intended objectives of the organisation.

Strategic flexibility – the necessary dynamic capabilities that an organisation must have to deal with uncertainty and risk in responding to the demands and opportunities in uncertain competitive environments.

Strategic intent – a concept that envisions a desired leadership position as well as the criteria to be used to measure progress.

Strategic leadership – the leadership of an entire organisation through influencing people and providing a sense of direction for the achievement of a common goal, growth and sustainability.

Strategic orientation – involves an organisation's cultural strategic predisposition, whether an ethnocentric, polycentric, regiocentric, or geocentric predisposition toward its international business involvement as a frame of reference for its international strategic planning and operations.

Strategic risk management – the continuous process of identifying and determining the extent of strategic risks and putting in place strategies that reduce or eliminate risks that may influence the attainment of the business strategy, objectives and implementation of strategies.

Strategic risks – risks that prevent the organisation in achieving its long-term goals.

Strategic thinking – a mental or thinking process applied by an individual in the context of wanting to achieve success in an activity.

Strategic timeframe – the period of time that is prioritised when making strategic decisions, such as investment decisions. This includes in particular the period of time that is prioritised when considering financial returns from such investments.

Strategies – courses of deliberate action that strategic decision makers take to match the organisation's unique strengths and capabilities with the opportunities in the external environment.

Strategy – the direction and scope of an organisation over the long term, which achieves advantage for the organisation through its configuration of resources within a changing environment and to fulfil stakeholder expectations.

Strategy implementation – putting strategy into effect; making strategy happen; executing strategy.

Sustainability – the maintenance and enhancement of environmental, social and economic resources to meet the needs of current and future generations.

Sustainable competitive advantage – an enduring edge over competitors in attracting buyers and coping with competitive forces.

SWOT analysis – the comparison of the strengths, weaknesses, opportunities and threats of an organisation for strategic planning purposes.

Technology – the application of science to improving the organisation's operational capability, which includes office, service and manufacturing technologies.

Technology S-curve (also known as the **technology life cycle curve**) – a plot of the relative performance of a technology against the engineering effort required to develop/sustain it.

Threshold capabilities – the minimum capabilities needed by the organisation to compete in a market.

Transformational leadership – leadership based on motivational principles which seeks to engage followers in the goals of an organisation.

Transnational strategy – a strategy pursued by globally networked companies to increase profitability by exploiting experience-based cost and location economies while simultaneously complying with local responsiveness in foreign markets.

Ubuntu – a philosophy or worldview relating to our humanity, the idea that ‘I am because of other people’.

Value chain – the chain of activities in which an organisation engages to add value to a product.

Value innovation – is a type of strategic innovation that can be used to create new markets and thus create market spaces where the competitors are not relevant.

Value statement – a statement that reflects the future standing of the organisation, and typically comprises a set of key values or behaviours to which employees should subscribe.

Values – the standards by which all employees set priorities and define the rules that they should follow to achieve a sustainable competitive advantage.

Vertical focus – refers to the phases in the industry value chain in which an organisation is active.

Vision statement – a statement that articulates the ideal description of the organisation.

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